Hoarding DOLLARS

The Real Implications for FX

Armstrong Economics

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By Martin Armstrong

ArmstrongEconomics
researching the past to predict the future

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Contents

Hoarding Dollars

The bias against the dollar has been turned into a religion primarily propagated by the Gold Promoters. This constant bashing of the dollar and how it will be terminated, and the world will return to some mythical gold standard has led to such propaganda against currencies in general, people cannot see the truth even when it smacks them in the face.

These Gold Promoters know nothing about monetary history and even less about how the monetary system collapses historically. All such monetary systems die much like a human body. The extremities are the first to grow cold and then it moves into the center where the heart finally stops. The peripheral economies are where you will always see the first signs of a terminal illness. Capital withdraws from the outer lying economies and contract back into the financial capital of the world at that moment. As the peripheral economies go into crisis from a lack of capital, defaults begin to spread like a contagion. Panic typically sets in and then spreads eventually inflicting the core economy.

Even if we look closely at real estate, you will witness the same exact trend. From a low, the first property to rise is typically in the major city centers – the core. As that property appreciates, people begin to buy the surrounding regions. Then watch the core and where it all began. Once the property which first rose in value and began the entire trend starts to decline, that contagion will spread into the peripheral regions. Once the crash has subsided, the cycle will begin again as capital is attracted back to the core.

This obsession with a return to a gold standard is quite absurd. Every fixed exchange rate system has always failed because you cannot fix anything in a world that functions under a business cycle. They want money to be tangible but then they want to make profits on everything else yet somehow money is to remain some constant value. This is true sophistry for if tangible assets rise in value expressed in whatever you call money, then the purchasing power of that money must decline.

It has been this dominant bias which has prevented the majority from comprehending that there is a (1) a major dollar shortage, and (2) a significant degree of dollar hoarding which has resulted in about 70% of all paper dollars now circulating outside the United States. On top of that, there are now more $100 bills in existence than there are $1 bills.

Hoard of 52,000 Roman Coins
3rd Century AD discovered in Britain 2008


Roman Bronze Hoard
Late 4th Century to early 5th century

Even during the hyperinflationary period of the 3rd century during the Roman Empire, we still find people hoarding the debased coinage. The idea that they would only hoard the precious metal coins as Gresham's Law proposed, bad money drives out good from circulation, we find that when the government is perceived to be collapsing, they even hoarded the debased coins.

Despite the bearishness projected by the Gold Promoters, dollars are being hoarded around the globe. When there are deep rising concerns about the political viability or Europe, protests raging in Hong Kong and rising fears that the peg with the US dollar will fail, throw in the uncertainty rising in Britain and Japan, not to mention the Middle East and the turmoil in South America, it should come as no surprise that the greenback is seen as the safe harbor for capital.

1861 $5 Demand Note

The United States has been the only country which has **NOT** cancelled its currency. The first paper currency issued in 1861 is still legal tender and can be spent to this day, although they are worth far more than their face value to collectors. The fact that US does not routinely cancel its currency as is the case in Europe, lends the greenback to its unique status of the best currency to hoard around the world. With the push to abandon physical money and move to the world of electronic or digital money, things are changing. During this transition period, it is the dollar which is rising in demand – not declining. As the world faces the extinction of physical money combined with political instability, the demand for dollars will only rise – not diminish.

Winds of Change: The Rise of New Digital Currency

The winds of change are blowing rather briskly. They once powered ships which explored the world and gave birth to intercontinental commerce. In the world of economics, change is always the perpetual constant which ensures that tomorrow will always be different. This is no different from climate change which people try to blame on human which means they are presuming that the climate should not change. But no matter what we look at, change is indeed the one thing that forms a constant just and the cycle of birth, life, and death which dictates the fate of everything from plants and humans to planets and stars.

Nevertheless, change often appears troubling to many and outright destabilizing if not threatening. This is especially true for technological change, which disrupts jobs that many people are unable to adapt. When the jet engine arrived, many pilots who flew prop planes could not cope with having to make decisions in shorter time intervals.

"I'm naming you VP of Revolution, Action and Edgy Thinking ... on one condition ... that you promise not to change anything."

Employment in agriculture was 40% of the work force in 1900. With the technological changes which brought the combustion engine giving birth to tractors and combines, by 1980, employment in the agriculture sector declined to just 3%.

Understanding that there is always a cycle to change. The key to coping with the cycle of change is to clearly understand the trend and to then harness the benefits while managing the risks. What we must understand is that inevitably we are going to be faced with the changing nature of money. This is often referred to as the **FinTech Revolution** which stands for Financial Technologies.

Nevertheless, as money has changed, so has the role of central banks where many are insisting that each central bank should abandon paper money and move to digital currency. It is this new financial landscape where there has been an effort to move to the world of digital currencies that many look at as the perfect way to ensure that governments collect all the taxes they can dream of. Then there is the pretense that this will also eliminate crime and terrorism. A drug dealer will be unable to sell his illegal products if there is no money to pay them. It has been also proposed that digital currencies will eliminate bank runs as well as bank robberies.

Obviously, the changing nature of money and the Fintech Revolution present some serious disruptions to the world economy as we enter this transition period. There remains a major question that many do not contemplate or even dare to think might take place. That is the stark question – Can the world move to digital currency on an ad hoc basis? Is there a risk of financial chaos if only some countries adopt a digital currency while others do not? What does history have to offer as a possible guide to such transition periods with respect to changes in money and the unit of account?

The Changing Nature of Money

Minoan Bronze Ingot Resembling Sheep Skin
circa 1400 - 1000 BC

The changing nature of money has always existed throughout the history of civilization. During the earliest stages of civilization, the monetary system was based upon barter. However, commerce cannot truly develop under a barter system without an agreed upon medium of exchange. Someone who has excess apples may not be able to exchange them for a pear if the person with the pears also has apples.

The first thing to emerge in commerce was an agreed upon medium of exchange. In western culture, that tended to be sheepskins or cattle. What is interesting is as the Bronze Age lasted from roughly 3300BC to 1200BC. Suddenly, bronze emerged as the medium of exchange for it could serve as a tool or a weapon. The Minoans which were the Financial Capital of the ancient western world traded bronze ingots which were in the shape of the former medium of exchange which was the sheepskin.

Cowrie Shells

The medium of exchange simply had to be something upon which everyone agreed. In China, money emerged as cowrie shells. Whatever emerged as the medium of exchange did not have to have a use value. Gold and silver had not use value other than they were desirable as was the case with the cowrie shells distinctly different from cattle, sheepskins, and bronze.

Roman *Aes Rude* ("*rough bronze*")
Lumps of Bronze used as MONEY from about 8th Century BC

In prisons, that medium of change began cigarettes even if someone did not smoke, he accepted them as money knowing everyone else would accept them in return. This eventually became packets of marcel fish when cigarettes were banished from prisons. It did not matter if you ever ate marcel. It was money in a prison.

While Romans traded bronze in lumps of varying weights, it was in Anatolia (modern–day Turkey) where the medium of exchange became electrum, which was a natural alloy of gold and silver found mostly in the Sardis river.

Therefore, the first precious metals to emerge as a medium of exchange was this natural alloy which also varied greatly in the gold content. The very first innovation was to standardize the weight of the metal giving birth to the beginning of coinage.

Therefore, the transition is easily seen in this photograph where there is a standard weight with a punch mark on the reverse. This was succeeded by a geometric design. The coinage up to this point in time was clearly private in its invention.

The third example has the punch mark on the reverse, but now you see the design of a lion's head which was the symbol of the king of Lydia. Here we have the first example of government intervention in the private manufacture of currencies. The coin was now the official sanction of the king. This is indeed the same fate which await the cryptocurrency world. The IMF has gone as far as to recommend that each country officially create its own digital currency. Thus, we will witness the very same evolution take place from private digital currency to official governmental issue as we have just seen in the development of coinage.

When coinage first began, it facilitated only local commerce centered around the town square. However, the invention of coinage which took place in Lydia, quickly spread to the other cities in Ionia. It was Lydia which was also the place where Western philosophy began.

The many cities in Ionia began to all issue their own coinage with the image of their city–state. The electrum coinage most likely was struck for about 51.6 years. We begin to see the emergence of a bimetallic monetary standard emerge in Lydia about 560BC where the state refined the raw electrum and separated the silver from the gold.

King Croesus (Kroisos) (560-546BC)
First Bimetallic Monetary System

King Croesus of Lydia obviously began the first bimetallic monetary system, but he may have been inspired by the Greeks of Aegina. During 6th century, the Greek isle of Aegina was the first to issue coinage since they were the major maritime power. Unlike the Ionians, their coinage was struck in silver lacking gold or electrum. In their travels, the merchants obviously encountered the developing early electrum coins in Lydia.

Aegina Silver Tetradrachm
(600-550BC)

They recognized the potential to optimize trade through a common currency. Aegina therefore became the first of the Greek city-states to issue coined money, starting in the mid-sixth century BC. Hence, it is impossible state definitively that Aegina was the first to issue silver coinage which influenced King Croesus, or was it the other way around?

The exchange of coins from one hand to another settled transactions and this type of monetary system served well for the development of civilization. While some say money is the root of all evil, it was the spark which created civilization enabling international commerce. Without money, the exchange of goods and services was limited to barter. Only the development of coinage allowed civilization to expand and became the alternative to force. Under a barter system, the inability to complete a transaction would lead to plain violence.

We find that the very same trends that exist today emerged in ancient times. The dominant currency of the financial capital of the ancient world became the effective reserve currency back then. In this case, it was the Athenian Owls which inspired jealousy back then as is the case with the United States today.

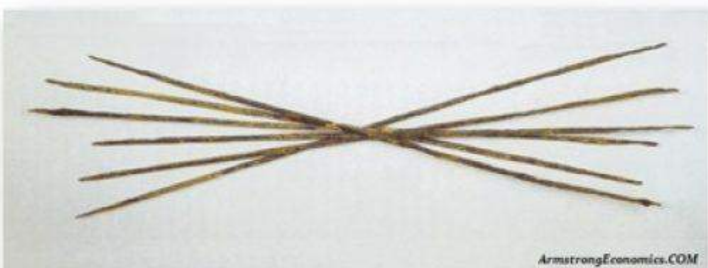
What took place back when Athens became the superpower and Financial Capital of the Ancient World was rivals dislike such a concentration of power. It has been called the **Thucydides Trap**, which is named after the ancient Greek historian Thucydides who wrote about a war that devastated the two leading city–states of classical Greece – Sparta & Athens. Thucydides explained:

Thucydides
(c. 460—404BC)

> *"It was the rise of Athens and the fear that this instilled in Sparta that made war inevitable."*

While Thucydides provided his opinion, there was another backdrop to this war which he did not cover. Looking at this from an economic issue, it was the ancient clash between Capitalism and Communism. Sparta never issued coins whereas the Athenian Owl coins became the international currency recognized even in barbarian regions.

Sparta v Athens - Clash of Philosophies



The origin of Greek coinage was the Obol

(ancient Greek: *obolos*, literally "spit, iron rod") According to Plutarch, the Spartans had an iron *obolus* of four *chalkoi*. Sparta chose to retain the use of the crude and cumbersome, impractical "*oboloi*" for their monetary system rather than adopt any coinage in order to discourage the pursuit of wealth (see Plutarch, Lycurgus 9). This philosophy symbolized the virtual communistic view of Sparta. In Classical Athens, the *obol* became a silver coin 0.64 grams & six *obols* = *drachma* (meaning "handful")

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Sparta was an ancient communist–style state. Athens, on the other hand, was the Financial Capital of the Ancient world. They developed banking, insurance, and commodity markets. Sparta saw Athens as a decadent threat so it was one of power and fundamental disagreement with the economic differences between the two city–states. But Sparta had the backing of other city–states which were forced to pay tribute (taxes) to Athens.

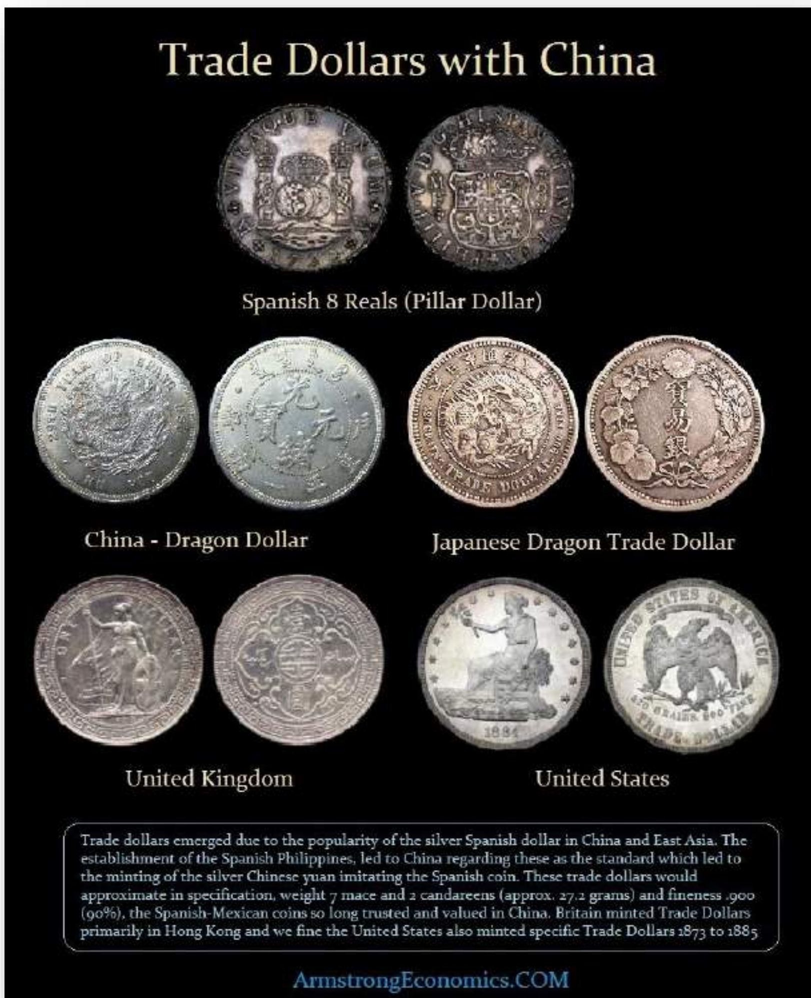
The **Thucydides Trap** is considered the violent aspect of the shift in the Financial Capital of the World. In most cases, the rivalry between the major power and the new contender has led to war. Only a few times the passing of the crown of the Financial Capital of the World changed hands without war such as the loss of that title from Britain to the United States. However, there was still war involved whereas Britain lost its economic status due to war in Europe primarily and then the rise of the Labour Party. It did not involve war with the United States.

Today, we are looking at the risk of a conflict between China combined with Russia against the United States as this struggle for power continues. The USA will lose the title to China. We see both China and Russia do not like the fact that the greenback is the reserve currency. This is the very same issue which rose in Ancient times between Sparta and Athens.

Therefore, money has often become a political issue. Countries have typically adopted the coinage of the dominant economy. Even Rome as it was rising adopted the Greek denominations in 280BC and issued coinage which was equivalent to that of the Greek monetary system in order to facilitate trade. It was during the Second Punic War (Spring 218 to 201 BC) when inflation compelled the Roman to reduce the weight of their coinage in 211BC. Because of their victory and subsequent conquest of Greece, the Roman denarius became the dominant reserve currency of the ancient world displacing that of Greece.

While the Chinese paper money was introduced during the 9th century, from an international perspective, it did not facilitate trade. The dominant currency by the 17th century had clearly become the Spanish 8 reales.

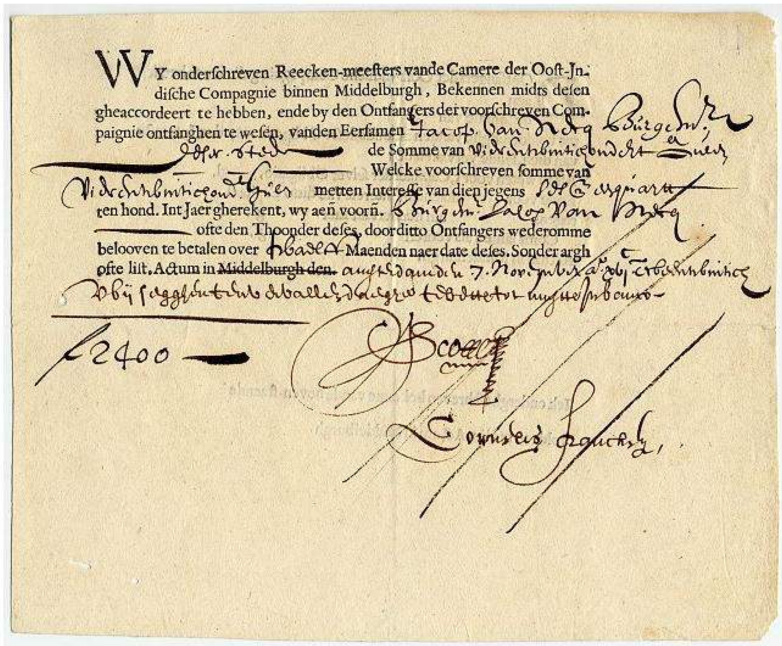
SPAIN 8 Reales, 1600-D of Valladolid Mint
Philip III (1598-1621)



The Spanish 8 reales became the international reserve currency and China adopted the silver standard – not gold. We then find Western nations issuing silver trade dollars which a specific weight to facilitate trade with China.

The history of money is a history of the rise and fall of empire, nations, and city–states. The most dominant economic power has **ALWAYS** seen their currency become the reserve currency of the world at that point in history.

There were such innovations as the bills of exchange which were paper documents allowing merchants with a bank account in their home city to draw money from a bank at their destination. The Arabs called these Sakks, the origin of our word "check" today. This practice of Bills of Exchange even existed in ancient times. They had reemerged under the Knights Templar which would issue a draft that would allow one to pay in a distant city where the Knights in that location would make the payment as directed. The innovation of Bills of Exchange spread around the world, and they were spearheaded by the Italian bankers and merchants of the Renaissance. In Asia, there were similar instruments known as the Chinese Shanxi and Indian Hundi bills.



A bond, denominated in 2,400 florins of Florence, from the Dutch East India Company, date November 7th, 1623, drafted in Middelburg, but signed in Amsterdam

In 1378, under Count Willem V the Dutch made their own version of the Florence golden florin (in Dutch: "gulden florijn"). Those two words were too long for everyday use and it eventually became known as just the gulden (guilder) and in the written language for a certain amount, say a 100 guilders, was written as Fl 100. (the FL stood for Florin)

We find the rebirth of institutional and sovereign debt emerge with bonds being issued more commonly during the early 17th century. The first paper money began to emerge in Europe in Sweden during 1666.

Why is this brief tour of history relevant? Because the fintech revolution questions the two forms of money we just discussed—coins and commercial bank deposits. And it questions the role of the state in providing money.

Japanese Monetary System (760 - 958AD)

The Japanese emperors adopted a practice that would devalue the outstanding money supply when they came to the throne and reduce it to 10% of its former value. This allowed the new emperor to issue coins as if he were beginning anew. By the time the third emperor pulled this stunt, the people simply refused to accept the coins of the emperor ever again. The Japanese resorted to using bags of rice as money and Chinese coins. Eventually, they also used ingots of silver or gold for larger transactions by the 18th to 19th century. Because of this practice, Japanese emperors lost the ability to issue money for 600 years until the Meiji reform in 1870 when the yen was born. The last official Japanese coin issue was in 958AD. The Meiji Reform of 1870 set the yen at par with the US dollar based upon a silver yen which was the equivalent of the US silver dollar.

We are at a historic turning point in the evolution of money. What is emerging is indeed altering the future economy by reinventing monetary history. A new wind is blowing, that of digitalization which will allow governments to collect the desired taxes they believe they are entitled to. In this new world, everything is appearing on our smartphones. We exchange information, services, even emojis, instantly… peer to peer, person to person. But we are also buying goods and even food via the internet all connected with digital forms of money.

The millennials have generally surrendered privacy for convenience. We are witnessing the reinventing how our economy works, phone in hand. This is all changing money itself. We expect it to become more convenient and user–friendly and today they just hold up their phone to pay for coffee at Starbucks.

The expectations of the millennials have been reshaped to be integrated with social media where they post everything taking photos of what they are eating at every meal. In the course of this technological boom we expect everything to be cheap and safe, protected against criminals and prying eyes.

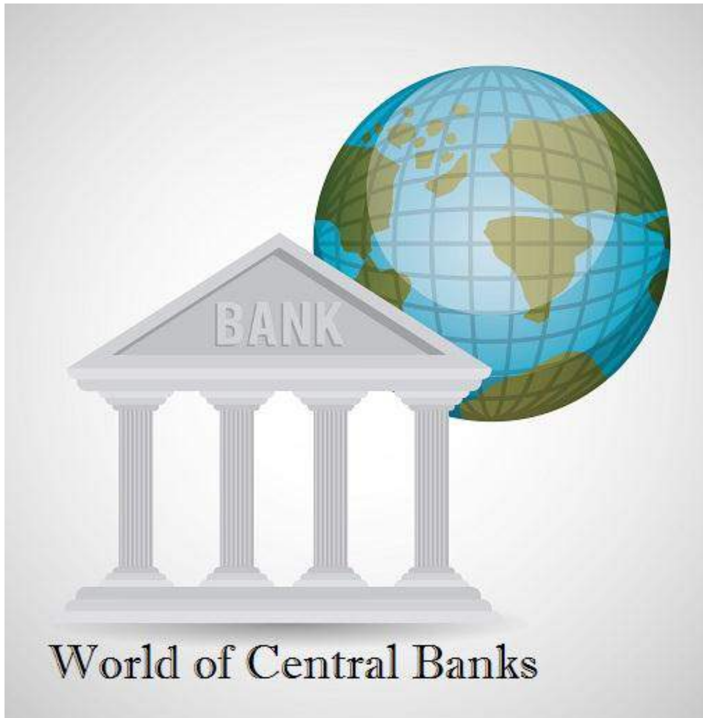
Scandinavia has been the poster child for the new cashless world. In various other countries too, demand for cash is decreasing among the younger generations. In another ten+ years, we may see paper money vanish completely. The incentive for governments to intervene will be tremendous. As the demands for payments on social programs will rise dramatically, they need taxes. We will witness the move toward digital currencies for the sole purpose of taxation.

Nevertheless, the world of crypto currencies will collapse. Governments will not tolerate private companies controlling the money supply. They have allowed them to operate in order to get people to **BELIEVE** this is the way of the future. However, at the end of the day, each country will adopt its own digital currency and eliminate paper money.

There has been a steady evolutionary trend toward the use of digital forms of money including debt and credit cards. Consumers continue to use cash predominantly for smaller value transactions, with cash being used for 55% of payments under $10 and for 32% of payments between $10 and $24.99. Therefore, on purchases of less than $25, cash still remains the most used instrument overall in the United States.

Debit and credit cards are generally used for larger transactions. The details breakdown to the average debit and credit transaction being $46 and $67, respectively. For purchases under $25, debit cards were used 34% of the time. Since 2017, there has been a rise in the use of debt cards where by they are being used on these smaller transactions at a higher rate than cash.

The cryptocurrencies such as Bitcoin, Ethereum, and Ripple are vying for a spot in the cashless world, and have been constantly reinventing themselves in the hope of offering more stable value, and quicker, cheaper settlement. Facebook may be calling its concept a cryptocurrency, but in all truth, it becomes not much different than PayPal.



The Central Bank Digital Currencies

The role of the government central banks in this new monetary landscape of digital currencies become absolutely essential to the control governments will insist upon retaining and expanding over the economy as a whole. The sales pitch of the cryptocurrency world has been to circumvent central banks and somehow this will end inflation or fiat currency. Those a really hallow dreams if not delusional. No government will simply surrender their economic power without a knock-down bloody revolution.

Providers of cryptocurrency and various forms of e-money argue that they are less risky than banks, because they do not lend money. Instead, they hold client funds in custodian accounts, and simply settle payments within their networks. This is deleveraging the economy and would actually create deflation. Without lending, housing prices would have to collapse to reflect a cash only market.

The cryptocurrencies seek to anchor trust in technology. Many such cryptocurrencies claim to be transparent seeking to gain your trust their services. Yet this claim of transparency only invites government regulation of these entities which in many ways defeats their original idea of circumventing central banks. This presents the clash between regulation or simply usurpation.

At the end of the day, every establishment would need to accept each and every cryptocurrency to make then truly a viable currency. Then there is the issue of legal tender. Can they be used to pay taxes?

The question will emerge asking should central banks issue a new digital form of money directly? Because of the trend toward collecting taxes and the drive to hunt taxes which is emerging around the world, it seems inevitable that a state–backed form of cryptocurrency will be introduced. The account will be held directly at the central bank for clearing. In reality, deposits in commercial/merchant banks are already digital. About 10% of the $60 trillion of money worldwide is in physical coin or paper form. Obviously, the bulk of the money supply is already digital.

Various central banks around the world are seriously considering moving to create their own cryptocurrencies. The Canada Revenue Agency has characterized cryptocurrency as a commodity and stated that the use of cryptocurrency to pay for goods or services should be treated as a barter transaction. The government does not accept payment for taxes in any cryptocurrency. Leaks within the Bank of Canada show officials are considering the development of a national cryptocurrency. As such, with interest in central bank digital currencies (CBDCs) on the rise, this will ultimately lead to banning private cryptocurrencies.

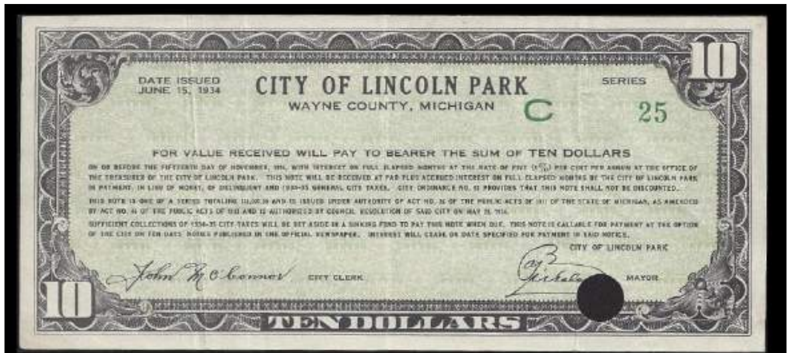
The creation of national cryptocurrencies goes beyond Canada, and is moving to China, Sweden, and Uruguay. They are embracing change and new thinking that increases tax revenues.

The considerations of creating national cryptocurrencies have been focused on domestic economies. There have been no true cross-border effects of digital currency taken into account just yet outside of the use of Bitcoin for money laundering in China.

China called all Bitcoin exchanges to a closed-door meeting back in February 2017 looking to shut down the flight of capital from China where Bitcoin became the money laundering instrument. Bitcoin has been the escape method for capital fleeing China. China's major Bitcoin exchanges halted or otherwise updated their Bitcoin trading services. The changes to Bitcoin were being made in response to interactions with the People's Bank of China which delivered "informal guidance" regarding capital flight through Bitcoin exchanges

Effectively, loan-based trading services were no longer available using Bitcoin. The news spread quickly about the changes on social media. Margin trading services had always been in the grey area given the longstanding lack of legal clarity that allowed the exchange to blossom. The additional liquidity for Bitcoin that came from China began to decline.

Chinese regulatory authorities had imposed a ban on initial coin offerings (ICO), a cryptocurrency-based fundraising process, and declared it to be illegal in China as of September 2017. That ban triggered a 6% crash in Bitcoin prices. Following the ban, the Shanghai-based BTCC Bitcoin exchange was forced to close its Chinese trading operations.



Depression Scrip 1934 issued by
City of Lincoln Park, Wayne County, Michigan

Financial Distribution

One of the problems during the Great Depressions was the lack of circulation of money due to hoarding which caused shortages of cash in many cities. This led to the creation of Depression Scrip by more than 200 cities in the United States. The shortage of physical paper money led to the creation of lo0cal currencies to facilitate commerce. Therefore, digital currency could offer promise in ensuring the money supply is more financially distributed which may eliminate the pocket of scarcity in local communities during a crisis.

Indeed, if the paper money is eliminated and replaced with digital currency altogether, economic life in the periphery of small communities would in theory no become so disconnected from the center or core of the economy.

Privacy

The most serious issue would be the loss of privacy in the new world of digital currency. Cash, of course, allows for anonymous payments. We reach for cash to protect our privacy for legitimate reasons which rises during a financial crisis when the fear of a banking crisis emerged and of course the risk of exposure to hacking.

The way Google and Facebook collect data allows for targeting individuals not with just advertisements, but to determine what sort of political propaganda you might be susceptible to base upon purchasing habits. In the world of digital currency, we will clearly lose control of what little privacy that remains. If everything we buy is now in a database, we will be carved up and fed selective propaganda which will be different from the person next door.

Downsides of Bank Digital Currencies

The potential downsides of digital currency extend beyond the loss of privacy. The obvious risk will be to financial integrity as well as financial stability. In order to provide financial integrity requires the surrender of total privacy. There is really no middle ground on this issue.

In order to conduct commerce in the digital currency world, the users' identities would be authenticated before accepting the transaction. That becomes a slippery slope leading to facial recognition and fingerprinting. How do we protect that data? So far, that has not been something consumers have been able to win against Google and Facebook for example. But a program from Microsoft and you must maintain an account so it knows where you are and what you are doing.

Anti-money laundering and terrorist financing controls would nevertheless run in the background. If a suspicion arose it would be possible to lift the veil of anonymity and investigate. We have seen already the abuse of such information that inspired Edward Snowden to expose what was going on behind the curtain that government always denied.

Risks to financial stability seem to be the same with respect to commercial/merchant banks. The risk to a national digital currency appears to be no greater than the current system.

The Transition to Digital

There is no question that the move toward digital currency is unfolding rapidly outside the United States. The failure of Quantitative Easing by the European Central Bank (ECB) has left few options still on the table. With the economy of Europe turning down rather hard into early 2020, the prospects to raising interest rates is not viable.

The concerns in Europe have been about hoarding of cash. The discussions have been all along about how to prevent people from saving with the introduction of negative interest rates in 2014. But after 5 years of this failed policy, all they managed to do was increase the prospects of hoarding to avoid being taxed for simply trying to save for a rainy day.

With Cristine Lagarde taking the post of the head of the central bank on November 1st, 2019, he position has been while at the IMF has been to move to digital currencies. The IMF has been recommending that countries begin to issue their own digital currency and thereby eliminate paper money which will end hoarding. Therefore, it is widely expected that given her position to eliminate paper currency, we should expect the risk of cancelling the currency in Europe as increasing for 2020.

The prospects for the cancellation of the Euro in Europe are far greater than they are in the United States. This has led to the increased hoarding of US dollars throughout Europe. Trump would never eliminate paper currency any more than he would send troops into war. These are two primary reasons why the hoarding of dollars in Europe has been on the rise.

As stated previously, about 70% of the paper supply of dollars now resides outside the United States. There are also now more $100 bills in circulation than there are $1 bills. All of this adds up to the justification to hoard dollars outside of the United States. This historically has always been the case even from ancient times where peripheral economies will always hoard the currency of the major economy which is the Financial Capital of the World.

Hoarding Currency of Dominant Economies

Throughout history, whenever people lose confidence in their own government, they begin to hoard currencies of other countries. This trend has existed since ancient times. Hoards of silver Athenian tetradrachms (Owls) have been discovered all around the ancient world demonstrating that the Owls were the first true reserve type currency that circulated in the known ancient world much as the US dollar has done today.

Athenian Owls were discovered in Egypt, all of which date back to the 5th century BC, long before Egypt ever issued its own coins following the conquest of Alexander the Great in 332BC. This confirms that the Athenian Owls were in fact widely circulated and their discovery in Egypt which did not produce coinage for nearly 100 years later, demonstrates their wide acceptance. Indeed, imitations of the classical Athenian Owl coinage can be found throughout the ancient world.

Imitations of the classical Athenian Owls attest to their status as the currency of the Financial Capital of the Ancient World. We can see from the small selection of imitations illustrated here that not only were they widely imitated, we find that they were still imitated during the 3rd century BC in the region of Afghanistan more than 200 years later.

Athens Owl Tetradrachm Contemporary Counterfeit
Fourrée Tetradrachm (22.5mm, 12.10 grams) most of silver plating missing

These are imitations and not counterfeits. The distinction turns on the metal content and the weight. They are of similar silver content and weight confirming them as imitations rather than as counterfeits which are typically bronze that has been silver plated.

You will note the test cut on the example from North Arabia. Owls would cut deeply into the coin to expose the center to ensure it was not a counterfeit of bronze that had been silver plated. The ancient forgers' most common method for producing a *fourrée* was to take a flan of copper, wrap it with silver foil, heat it, and strike it with the dies creating the appearance of a genuine coin.

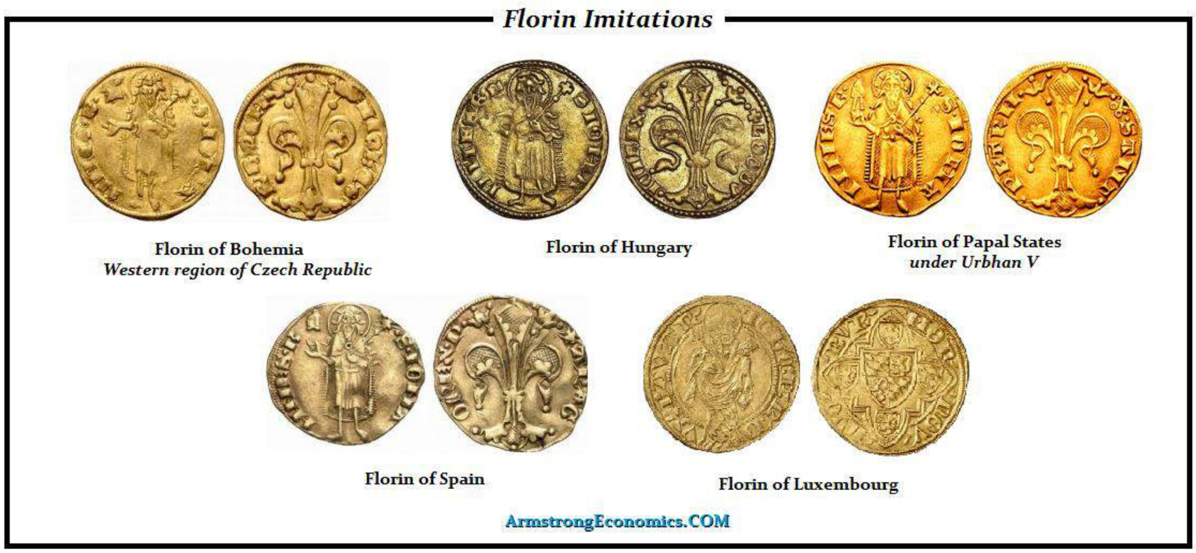
The Romans discovered how to apply a complex principle involving chemical oxidation and reduction that was not fully understood until this century. The ancients most likely discovered this chemical process by observing special rare cases in nature. The Romans officially plated their bronze coins during the 3rd century when the coinage was being debased.

From about 20AD until about 244AD, India routinely imitated Roman gold coins. This proved an important point. Obviously, the gold coins struck by the Roman Empire carried a premium over raw gold content. Many assume that coins traded on their metal content. That was just not true. We find imitations from the 5th century BC into the 3rd century AD where the metal content was equivalent but clearly the coins struck by the dominant economy were worth more than the pure metal content or there would be no purpose in imitating the coins.

Even when we look at the Byzantine Empire during the 6th century AD, once more we find the peripheral societies still imitating the gold coinage of the dominant economy. Here is an imitation of a Byzant made in the Slavic region.

Hoarding Currency of Dominant Economies

Florin of Florence
It was first struck in 1252 (3.5 grams)



Even during the 13th–14th centuries, we find that gold Florin of the Republic of Florence which began to be struck in 1252 became the dominant currency in international trade. The practice of imitating the Florin was widespread throughout Europe.

As previously mentioned, Japan lost the ability to issue coins as the people restored to using the coinage of China. Even during the hyperinflation of Germany during the 1920s, the people resorted to using the coinage and paper currency of surrounding states.

Therefore, we will always find the currency of the dominant economy is highly prized. In this case, the US dollar cannot be imitated. Paper currency can only be counterfeited. This has resulted in the hoarding of dollars directly around the world rather than being imitated which has been the general practice for centuries.

The Deutsche Bank Moment

The future yet to unfold is of great concern for there is tremendous confusion concerning the **Repo Market Crisis** which nobody seems to understand. We have a huge shortage of dollars building in Europe yet an excess of dollars domestically. What we are witnessing in the unraveling of globalization.

The US bailed out the banks during the 2007–2009 Crisis taking the toxic debt out of the domestic banks which actually allowed them to recover. In Europe, because of the demand of Germany that debts could not be consolidated in order to join the Euro for fear of excess debt coming from Southern Europe, the European Central Bank left the toxic financial waste inside the European banks and cut rates to negative in hopes that they would make enough money to cover their losses. That strategy simply has not worked so the crisis from 2007–2009 has yet to be resolved in Europe. As a result, we have a major shortage of dollars in Europe and others are afraid to lend to banks in Europe due to counterparty risk.

This has left Europe's biggest bank, Deutsche Bank, still in crisis mode and its stock has declined reflecting the real problems that have never been resolved. Historically, when a stock falls as far as that of Deutsche Bank, the entity does not survive.

Our capital flow models are indicating that there is a high concentration of dollar hoarding taking place in Germany as fears continue to exist over the future for Deutsche Bank. The intense fears over Deutsche Bank are centered on its derivative book. The true danger is that there are cross-positions which are entangled throughout the banking community which stretch even into the United States.

The performance of Deutsche Bank shares reflects the crisis in European banking and why Europe has been unable to recover 22 years later. It is their derivative book which has tentacles that stretch with deep links to the major US banks which are highly involved in derivatives. There is a rising concern that this time with the culprit being a regulated bank in the EU which has sworn not to bailout banks, that there can be a major contagion. This time a European banking crisis can impact the US banks which the Fed cannot control as was the case back in 2007-2009 when the origin was the USA. The Fed went as far as to bailout American Insurance Group (AIG) for if it went down, it would have taken Goldman Sachs with it. They let Lehman and Bear Sterns fold because they were competitors of Goldman. The dilemma this time is the Fed cannot bailout Deutsche Bank.

The crisis in liquidity is emerging as players fear a host of scenarios but remember the Lehman Brothers and Bear Stern crisis took place in **REPO MARKET** first. For that reason alone, many banks/corporations are hoarding dollar instruments but are reluctant to put them in **REPO MARKET** for fear of default at any moment with no predictability of who has exposure to what. This rising fear of counterparty risk has led to many preferring to just park funds in the USA with the Fed.

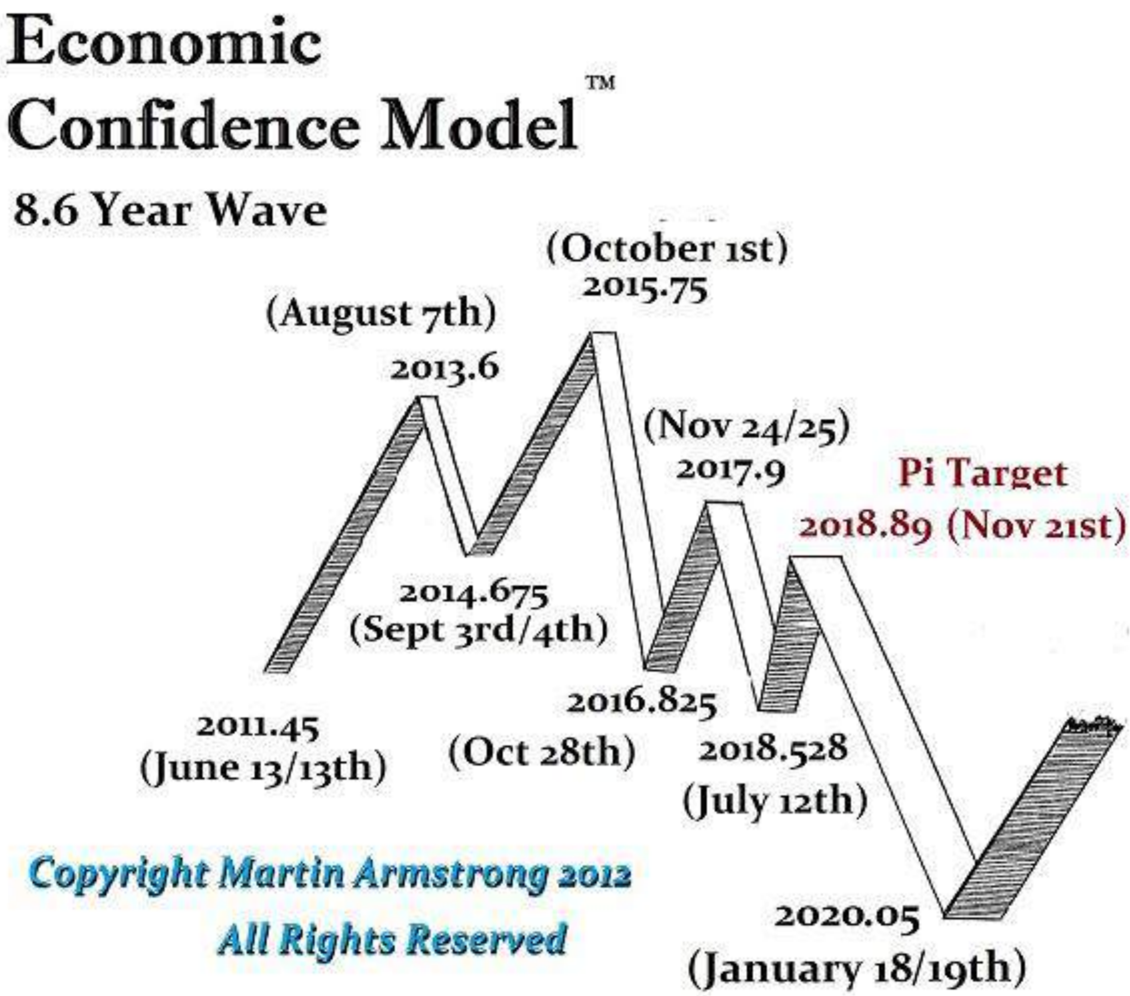
The bank stocks getting hit you will notice are all those with high derivative exposure linked back to Deutsche Bank. That means the leader in this banking risk decline is, of course, Goldman Sachs. The others in order of risk are Citigroup; Morgan Stanley; Bank of America, and JPMorgan Chase. The bank with the **LEAST** exposure in the USA to derivatives is Wells Fargo.

The big boys who play the Repo Market have also understood the game and how it changed post–2007–2009. They set up shell branches in different jurisdiction using the name of the bank. Therefore, you may think you are dealing with a major name, but the actual entity you are dealing with is a shell company set up where its capital might be just $1,000. This game playing has also contributed to the unraveling of Globalization in the financial markets because it has raised deep concerns about who you are really dealing with raising the problem of counterparty risk.

Our forecast for a liquidity crisis starting after Labor Day was spot on. The July high has held in the US share market and the Directional Changed began in September going into October/November. We could see the dollar hoarding and the shortage of dollars in Europe was building to a climax. Thus far, the Federal Reserve has had to funnel billions of dollars every day into the **REPO MARKET** providing an emergency source of liquidity to prevent another meltdown. This time, the economic pressure will continue into the turning point on the **Economic Confidence Model**. Notably, Deutsche Bank is heavily interconnected to the behemoths of Wall Street through derivatives.

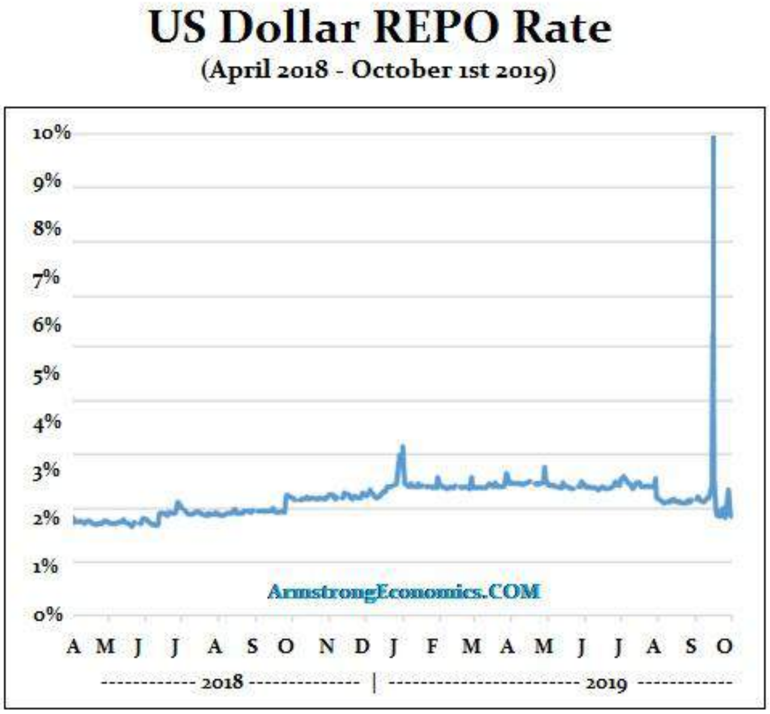
The U.S. banks that were named as being heavily interconnected to Deutsche Bank via derivatives in a 2016 report from the International Monetary Fund (IMF) were: Goldman Sachs; Citigroup; Morgan Stanley; Bank of America; and JPMorgan Chase. Among the insurers with exposure to Wall Street's derivatives' mess, Lincoln National has been at the top of the list.

It is also quite notable that Wells Fargo, which is the third largest bank in the U.S. by deposits, has fared far better than its peer banks. This further suggests that the selloff was all about derivatives and shaky counterparties since Wells Fargo has the smallest exposure to derivatives among the largest Wall Street banks according to data from the Office of the Comptroller of the Currency.



There is further proof that something is amiss with the largest banks on Wall Street. When the Fed offered its 14-day **Repo Loans**, there was twice as much demand as money offered by the Fed. The banks bid for $62 billion while the Fed was offering only $30 billion. This is further indicating that there is a shortage of dollars as hoarding is beginning to increase dramatically going into the turning point on the **Economic Confidence Model** (ECM) come January 2020.

The Federal Reserve announced that its **Repo Loan** program, which began on September 17th, 2019 after **REPO Rates** jumped to 10% on September 15th, would be extended into October. The Fed's open market operations have calmed the short-term funding market, but the central bank remains under pressure to find a solution to the cash crunch that sent rates spiking recently.



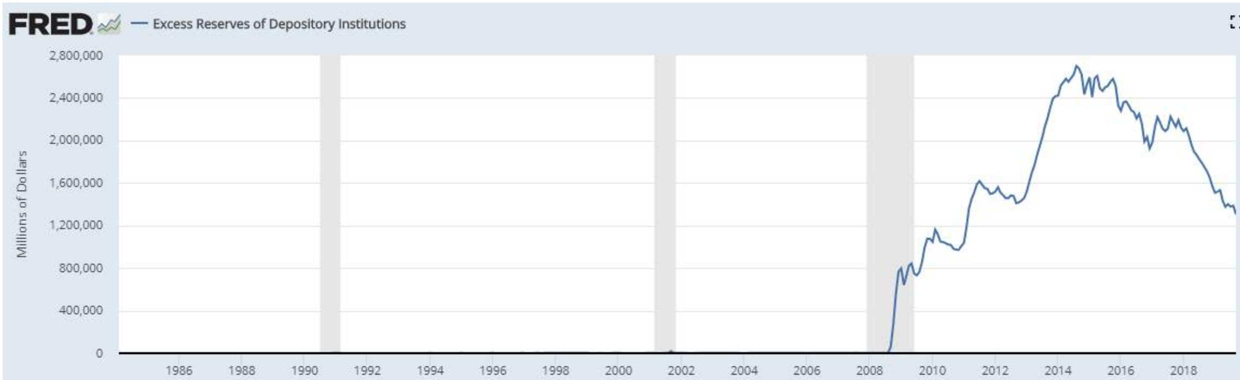
In a **REPO**, one party sells a security (such as a Treasury security) and then repurchases it at a higher price on a pre–specified date. **Repos** are an important source of short–term liquidity for financial institutions including hedge funds and are economically equivalent to collateralized loans. The 2007–2009 crisis took place because the credit rating agencies were bribed to rate Mortgage Backed Securities as AAA thereby qualifying them to be place in the **REPO MARKET**. When the loans could not be repurchased, suddenly this is what brought down Lehman Brothers and Bear Sterns in the blink–of–an–eye. This is why the first sign of panic has taken place in the **REPO MARKET** for that is where it all began in February 2007.

For depository institutions (such as banks), another important source of short–term liquidity is the federal funds market, where they borrow and lend each other bank reserves. The interest rate in this market, the federal funds rate (FFR), is the Fed's primary target for monetary policy. Because these private markets are similar, their rates are typically very close.

Although any individual bank chooses how many reserves it will hold, the Fed, counterintuitively, controls the overall level of bank reserves. Before the 2007–2009 financial crisis, the Fed kept the level of bank reserves relatively low and targeted the FFR through open market operations—primarily by using Repos. When it wanted to increase reserves and put downward pressure on the FFR, the Fed lent cash in the **Repo Market**. When it wanted to do the opposite, it borrowed cash in the **Repo Market**. Because demand for reserves shifts frequently, the Fed continually adjusted its **Repo** activity to keep the FFR stable.

The Fed's method of targeting the FFR changed significantly following the financial crisis 2007–2009. Given the Fed's crisis–response programs, such as **Quantitative Easing**, the Fed expanded the level of bank reserves from less than $50 billion to as high as $2.7 trillion. The Fed suddenly realized that it could no longer target the FFR using Repos because reserves were so abundant there was little need to borrow them. Consequently, the market clearing interest rate fell to zero.

Instead, the Fed began paying banks interest on reserves to target the FFR. This became the Excess Reserve facility which defeated the entire theory of **Quantitative Easing**. Banks simply deposited excess capital at the Fed rather than lend it out to stimulate the economy.



In 2014, the European Central Bank (ECB) took its interest rates to negative. The large European banks with US branches began to send capital to their US offices which were regulated by the Federal Reserve. Their US branch then posted its excess reserve with the Federal Reserve and earned interest. This only aided the decline in the Euro against the dollar as it crashed from its major high in 2008.

In 2014, the Fed began to **"normalize"** monetary policy, including gradually reducing bank reserves from over $2.5 trillion to around $1.5 trillion. Instead of returning to the pre-crisis model of scarce reserves, the Fed adopted a new strategy aiming to keep reserves just abundant enough that **Repos** would not be needed to target the FFR. Because of this strategy and the fundamental changes in market conditions with the clash of the ECB going negative, it became seriously in question exactly what level of reserves would meet the "just enough" theory. Events in September 2019 thrust this strategy to the surface creating highly unusual circumstances which were being impacted by fear of a Deutsch Bank contagion. Suddenly, the current level of reserves was not high enough to preclude the need for open market operations.

What Caused the Recent REPO Spike?

There is no indication that the recent spike in **Repo Rates** was caused by a domestic panic based upon economic conditions. Instead, tis sudden panic in the Repo Market was caused by what appeared to be a temporary increase in demand for cash and decrease in supply of bank reserves. But that was clearly not caused by a domestic change in economic conditions. Moreover, someone was chasing dollars desperately and thus willing to pay 10%.

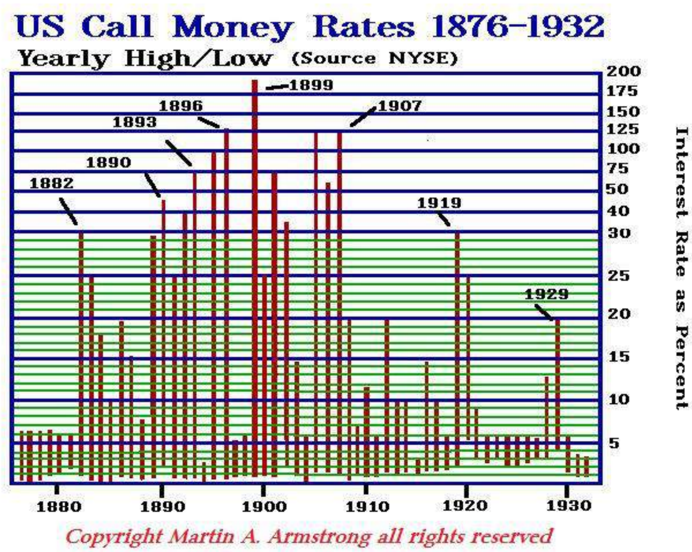
Some tried to argue that federal tax payments were due on September 15th which had something to do with the panic. When taxes are paid, money is initially transferred out of the reserve account of the taxpayer's bank into the Treasury's account at the Fed. That seemed to make some logical sense, but that would justify a single day – not a prolonged crisis. Then the second explanation put forth was that a relatively large Treasury debt issuance at that time similarly transferred money out of the reserve account of banks (who purchased the securities for themselves or customers) and into the Treasury's account. Again, that might in theory account for a single day – not a prolonged shortage of cash in the **Repo Market.**

Then there was the excuse that financial reporting requirements at the end of the third quarter had made banks temporarily less willing to lend in the Repo Market. That really made no sense whatsoever and was up there with I did my homework but the dog ate it.

Obviously, there was something else brewing behind the curtain in order for the crisis in the **REPO MARKET** to extend being a single day. It was even more that merely the changes in Fed policy pre-crisis and post-crisis.

These events certainly highlight several issues stemming from post-crisis monetary policy and financial regulatory changes. But they also exposed that we have a crisis on a contagion basis which necessitates us to look beyond the domestic borders.

During a liquidity crisis in which we have begun post-Labor Day, the shortage of dollars forces real rates to rise and that can be very dramatic. Don't forget that it was the **REPO MARKET** which brought down Lehman Brothers and Bear Stearns. This is why right now we have a counterparty risk concerns which is why they are forcing the Fed to come in and provide the cash. This is how the Free Market prevails. The Fed was poised to lower rates when the **REPO CRISIS** began. With rates soaring to 10%, this negated the Fed's ability to lower its Federal Funds rate.



In 1899, there was a major liquidity crisis when call money rates soared touching 200%. The Federal Reserve **did not exist** at that time, but the Bank of England (BoE) did. There was a surge in stocks and the BoE feared speculation. Their discount interest rate was set at 3% in February 1899. They intervened and doubled the interest rate to 6% in November 1899. This set off a major financial panic. The British investors in America were forced to sell assets to take money home to meet the liquidity crisis created by the BoE. This created a global contagion and the US market plunged into a massive liquidity crisis which was externally created by the BoE (International v Domestic policy objectives).

The USA had no central bank so the call money rates were a totally free market. The week of December 4th, 1899, saw the US share market collapse opening **BELOW** the previous week's low and plunged 20% in just two weeks. On December 18th, 1899, the call money rate touched 200% in the midst of this liquidity crisis.

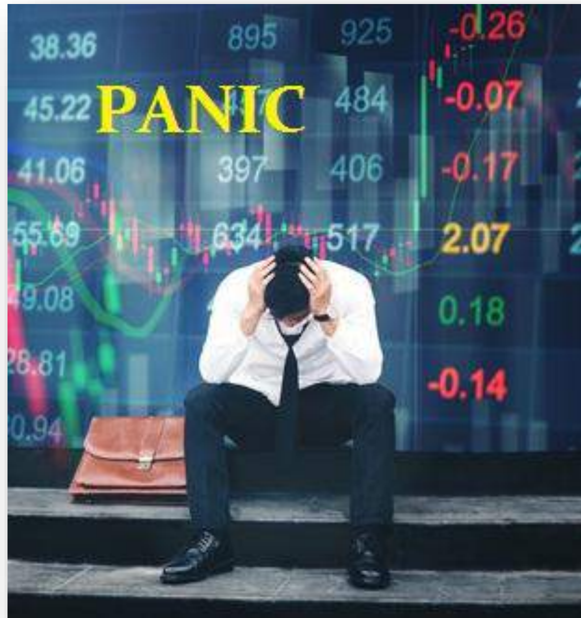
The Fed has three options to ensure Federal Funds Rate (FFR) stability under its Monetary Policy theory:

1. It can use continue interventions into the **REPO MARKET** (like the recent ones) as needed.

2. It can purchase assets to increase bank reserves to the point where the supply of reserves always exceeds demand and **Repos** are unnecessary in theory if the crisis is purely domestic.

3. It can create a standing **Repo** facility, where financial firms can borrow cash on demand, setting a rate on the facility that would put a ceiling on **Repo Rates**. Afterall, the Fed has previously created a similar facility that created a floor on **Repo Rates** known as the **Overnight Reverse Repurchase Agreement Facility**, whereby financial firms can lend the Fed cash on demand.

Clearly, such ad hoc interventions were widely accepted as the standard way to conduct monetary policy prior the 2007–2009 crisis. Monetary policy, by nature, involves some form of market intervention. A drawback to this approach is greater confusion and increased market volatility in interest rates.



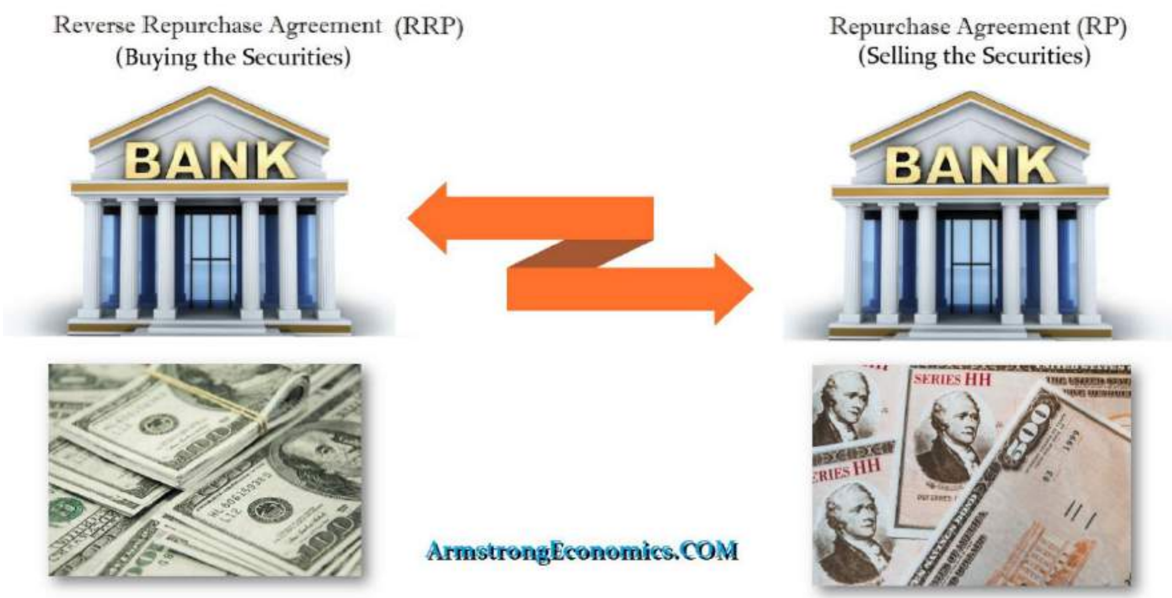
The Federal Reserve is facing urgent calls to find a permanent fix to short-term funding crisis in the **REPO MARKET** that has unsettled markets as a whole. The Fed is concerned about volatility at the end of the year when the demand for cash is expected to rise again seasonally. But the contagion from Europe over concerns with respect to their banking crisis remain off the headlines of mainstream media for fear that such news could spark another major crisis.

Traders were absolutely stunned by the September 2019 panic in the **REPO MARKET**. Many were far too new to the game given the last crisis was 10 years ago. This is an exclusive market for repurchase agreements where banks and hedge funds borrow money in exchange for Treasuries and other high-quality collateral that are not available for trading to the average player. The "**Repo**" rate jumped as high as 10%, prompting accusations that the Fed had lost control of short-term interest rates, but there was tremendous confusion as to even why a panic unfolded.

The panic forced the Fed to inject cash in order to bring the rate back down. Clearly, the Fed has lost control of even the short-term market rates which have been in their exclusive control creating confusion as to what is really going on. Many are now wondering what is taking place and have been pushing for a longer-term answer to this sudden crisis which is now impacting confidence.

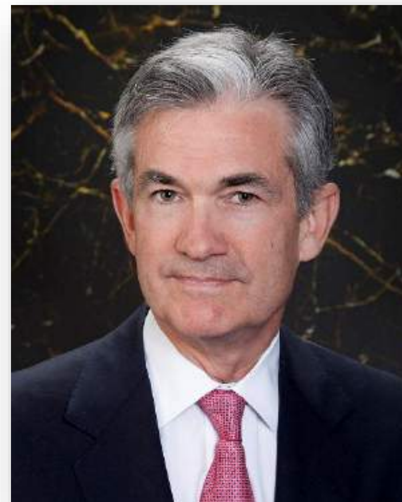
Market participants have appeared to reached an answer they are pushing upon the Fed – more asset purchases under Quantitative Easing to increase the cash in the system. When the Fed buys Treasuries from the market, it simultaneously credits banks' reserve accounts to pay for them, increasing the amount of cash in the financial system. However, this is purely a domestic myopic view of the economy which excluded influences from external markets. With the ECB at negative rates and the US at positive, then with the continued bearishness over European banking and the refusal of the EU to bailout banks, the central bank cannot hope to manage the economy when it cannot intervene into external markets.

Without question, something fundamental needs to be done. However, this crisis is stemming from Europe which cannot be controlled by the Fed and the ECB is locked into permanent **Quantitative Easing** which has utterly failed. At the worst of the market stress began with a series of daily $75bn cash injections. But this quickly morphed into $100bn overnight operations and three two-week loans. The crisis was not easing, but expanding ruling out the excuses that it was a one-time event due to tax payments and other nonsense. The demands for daily funding initially outpacing what was on offer from the Federal Reserve Bank of New York. The ad hoc intervention reached a sheer scale with roughly $200bn of cash on loan for the final day of September 2019.



Therefore, instead of taking cash out of the system, the Fed was compelled to inject cash doing a Reverse Repo. A Reverse Repo (RRP) injects is the purchase of securities with the agreement to sell them at a higher price at a specific future date. The party selling the security to raise cash in the market agrees to repurchase the securities (repo) from the lender at a future point in time which is known as a Repurchase Agreement (RP). Repos are classified as a money-market instrument, and they are usually used to raise short-term capital.

Consequ8ently, this was the first direct injection of cash to the banking sector since the 2007–2009 financial crisis. In the week of September 16th, 2019, there was a shortage of cash in the Repo Market which was being caused by the demand for dollars in Europe and the refusal of domestic US banks willing to lend to Europe. That crisis drove overnight **Repo Rates** to 10% from about 2% the week before. Even more disquieting, was the way volatility in the **Repo Market** pushed the effective federal funds rate to 2.30%, above the 2.25% upper limit of the Fed's target range. This disrupted the intended action of the Fed which was preparing to drop that ceiling to 2%. Suddenly, the shortage of dollar and dollar hoarding disrupted domestic policy objectives.



Fed chairman Jay Powell had to concede that the central bank will ***"over time provide a sufficient supply of reserves so that frequent operations are not required"***, in keeping with the **"*ample reserves*"** policy it adopted in January 2019. He did not offer any further explanation on what a sufficient supply would even be under the Fed's view.

This was simply because the Fed did not understand the cause was external and have begun to realize that this crisis is emerging from dollar shortage/hoarding sparked by fears emanating from Europe. We are witnessing the unraveling of Globalization and counterparty risk plagued by uncertainty.

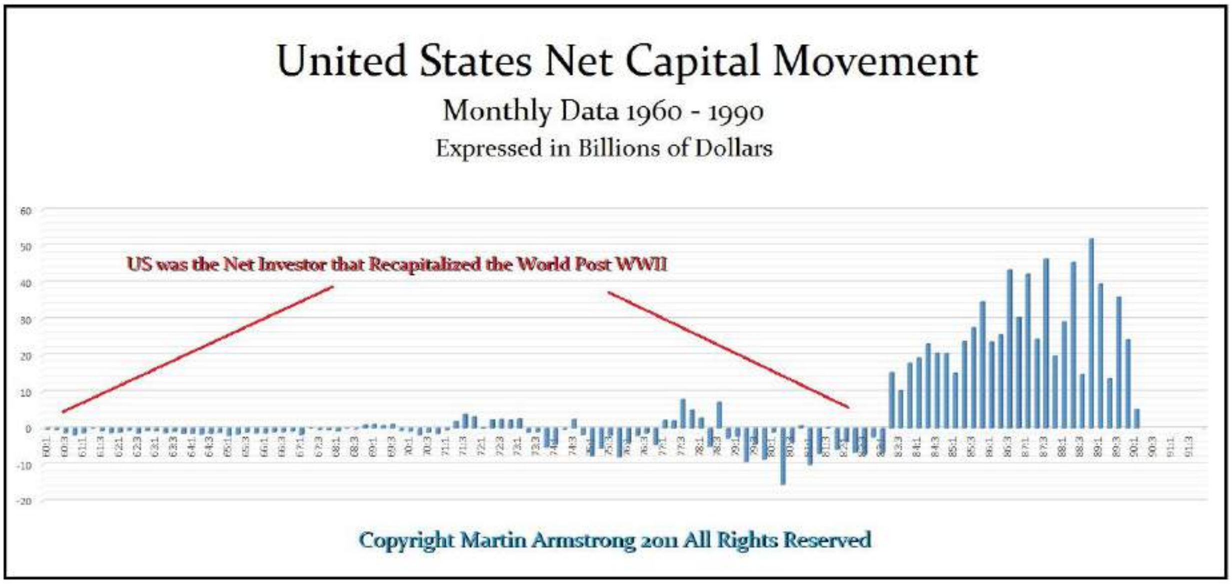
Nobody wants to lend capital out and have what could become known as a **Deutsch Bank Moment**. The policies of the ECB are so counter–trend to that of the Fed, we have an international crisis which is being forced upon the Fed unfolding as a major international contagion. To make matters worse, the artificially low interest rates have led to derivative plays being sold to pension funds further complicating the prospect of a major dollar crisis that is starting to unfold.

Dollar Shortages and the Marshall Plan

Parade honoring the Marshall Plan’s millionth ton of food for Greece, 1947

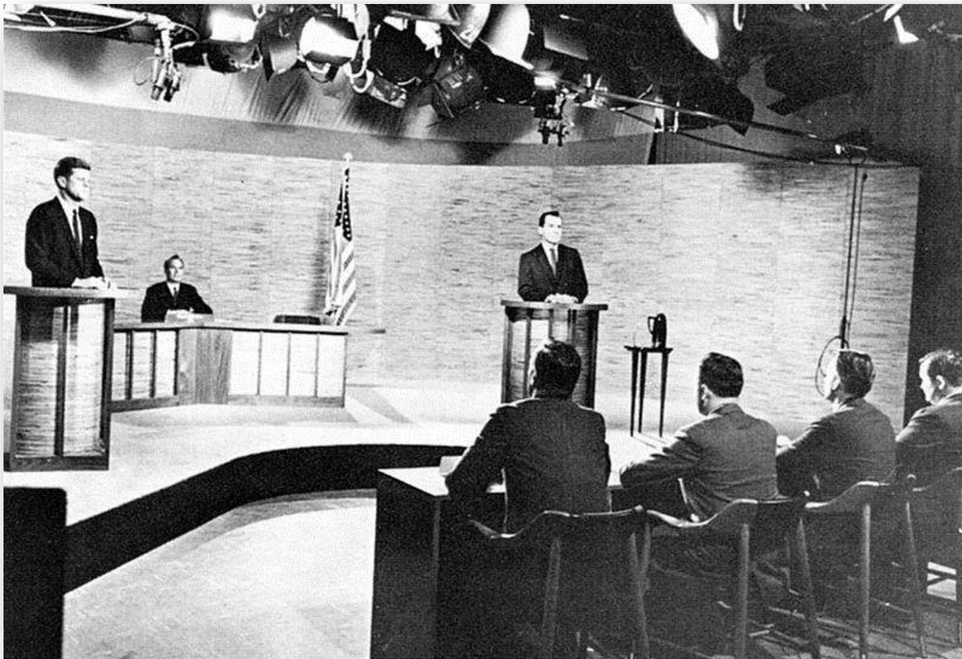
The last time there was a major dollar shortage was right after World War II. Bretton Woods arrangements were largely adhered to and ratified by the participating governments. It was expected that national monetary reserves, supplemented with necessary IMF credits, would finance any temporary balance of payments disequilibria. But this did not prove sufficient to get Europe out of its conundrum for what they failed to comprehend was that there was a serious shortage of dollars in the world economy given the collapse of governments in Europe having to begin again from scratch.

Postwar world capitalism suffered from a huge dollar shortage. The United States was running huge balance of trade surpluses at that time. The U.S. reserves were immense and growing because of the capital flight to the United States during the war. They began to realize that it was imperatively necessary to reverse this capital inflow to the United States.



Even though all nations wanted to buy U.S. exports to rebuild, dollars had to leave the United States and become available for international use so they could do so. Therefore, in practice, the United States needed to reverse the capital flows and in theory run a balance of trade deficit in order to help the rest of the world recover. This was indeed aided by the fact that the United States suddenly became the policeman of the world. By establishing bases around the globe and stationing American soldiers globally, the cost of those operations meant that there would be a net capital outflow which did not require the purchase of foreign goods they were not quite ready to produce. We can see that this was indeed the result which was not reversed until about 1983. The net capital outflows from the United States reconstructed the world economy.

During the **Third Debate**, of 1960 between Richard Nixon and John F Kennedy, the question about the outflow of gold from the USA reserves took place and set off a panic in the London gold market whereby gold rallied to $40 for the first time showing that the Bretton Woods System was indeed collapsing. The United States outflow of gold was not really from a trade deficit, but from the fact that the USA was defending the world with its military establishing bases everywhere. That meant capital was leaving. Gold would rally again up to $40 in the late 1960's and finally it forced the collapse of the convertibility of gold under the Bretton Woods System in 1971.



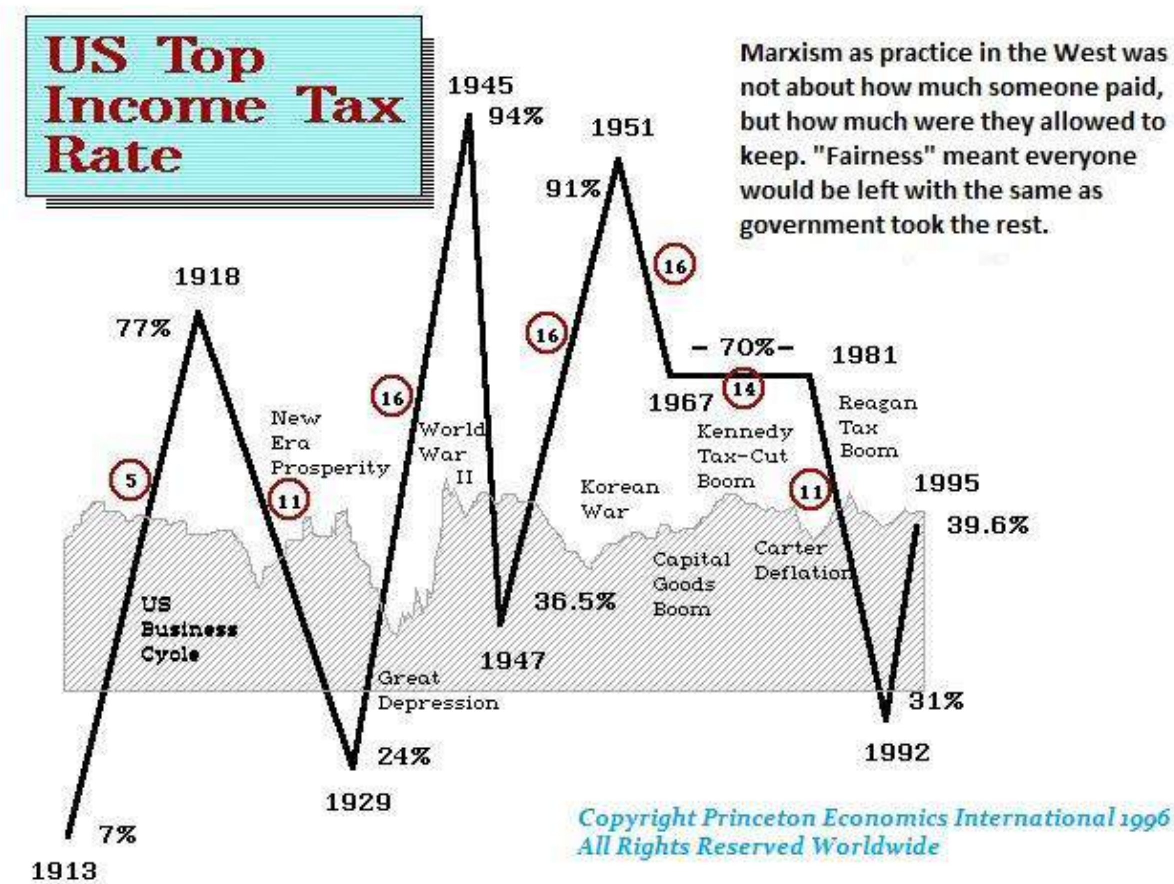
October 13, 1960 – The Third Kennedy-Nixon Presidential Debate

MR. VON FREMD: Mr. Vice President, in the past three years, there has been an exodus of more than four billion dollars of gold from the United States, apparently for two reasons: because exports have slumped and haven't covered imports, and because of increased American investments abroad. If you were president, how would you go about stopping this departure of gold from our shores?

MR. NIXON: Well, Mr. Von Fremd, the first thing we have to do is to continue to keep confidence abroad in the American dollar. That means that we must continue to have a balanced budget here at home in every possible circumstance that we can; because the moment that we have loss of confidence in our own fiscal policies at home, it results in gold flowing out. Secondly, we have to increase our exports, as compared with our imports. And here we have a very strong program going forward in the Department of Commerce. This one must be stepped up. Beyond that, as far as the gold supply is concerned, and as far as the movement of gold is concerned, uh – we have to bear in mind that we must get more help from our allies abroad in this great venture in which all free men are involved of winning the battle for freedom. Now America has been carrying a tremendous load in this respect. I think we have been right in carrying it. I have favored our programs abroad for economic assistance and for military assistance. But now we find that the countries of Europe for example, that we have aided, and Japan, that we've aided in the Far East; these countries – some our former enemies, have now recovered completely. They have got to bear a greater share of this load of economic assistance abroad. That's why I am advocating, and will develop during the course of the next Administration – if, of course, I get the opportunity – a program in which we enlist more aid from these other countries on a concerted basis in the programs of economic development for Africa, Asia and Latin America. The United States cannot continue to carry the major share of this burden by itself. We can a big share of it, but we've got to have more help from our friends abroad; and these three factors, I think, will be very helpful in reversing the gold flow which you spoke about.

MR. SHADEL: Senator Kennedy.

MR. KENNEDY: Just to uh – correct the record, Mr. Nixon said on depletion that his record was the opposite of mine. What I said was that this matter should be thoroughly gone into to make sure that there aren't loopholes. If his record is the opposite of that, that means that he doesn't want to go into it. Now on the question of gold. The difficulty, of course, is that we do have heavy obligations abroad, that we therefore have to maintain not only a favorable balance of trade but also send a good deal of our dollars overseas to pay our troops, maintain our bases, and sustain other economies. In other words, if we're going to continue to maintain our position in the sixties, we have to maintain a sound monetary and fiscal policy. We have to have control over inflation, and we also have to have a favorable balance of trade. We have to be able to compete in the world market. We have to be able to sell abroad more than we consume uh – from abroad if we're going to be able to meet our obligations. In addition, many of the countries around the world still keep restrictions against our goads, going all the way back to the days when there was a dollar shortage. Now there isn't a dollar shortage, and yet many of these countries continue to move against our goods. I believe that we must be able to compete in the market – steel and in all the basic commodities abroad – we must be able to compete against them because we always did because of our technological lead. We have to be sure to maintain that. We have to persuade these other countries not to restrict our goods coming in, not to act as if there was a dollar gap; and third, we have to persuade them to assume some of the responsibilities that up till now we've maintained, to assist underdeveloped countries in Africa, Latin America and Asia make an economic breakthrough on their own.



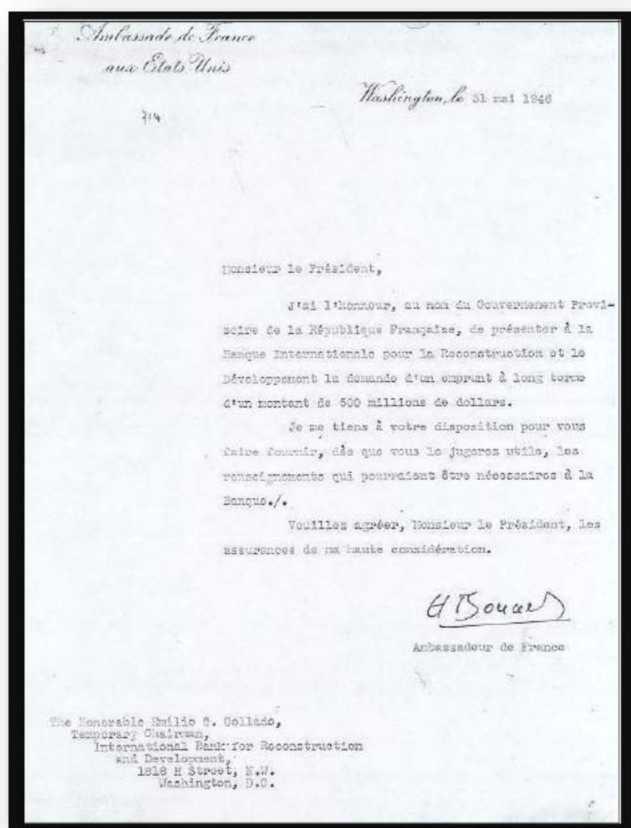
Speculative investment was actually discouraged by the Bretton Woods agreement. Importing from other nations was not appealing in the 1950s, because U.S. technology was cutting edge at the time. Consequently, it was the military expenditure which began the outflow of dollars. Eventually, multinational corporations began to emerge from the United States. As the socialist went crazy raising domestic taxes in the United States, they merely created the incentive for both individuals and corporations to move their capital and operations offshore. The top income tax rate reached 94% in 1945 to pay for the war, fell to 36.5% in 1947, but jumped back to 91% in 1951 for the Korean War. It was reduced by John F. Kennedy back down to 70% until the Reagan Tax Cuts in 1981 bringing it back down to 31%.

World trade was in a very serious state of imbalance immediately following the war. This imbalance reflected the stark problem that emerged between the capacity of the Western Hemisphere to produce goods for export and the urgent need of Europe and the Far East for imports for reconstruction.

Grants by governments to meet relief and rehabilitation needs in Germany alone were significant. From postwar to the middle of 1947, the grants and relief amounted to about $7.7 billion, excluding civilian supplies to Germany.

The reported gold reserves of Europe fell from $5.2 billion at the end of 1938 to $1.8 billion at the end of June 1947. This decline was largely accounted for by the fall in the reported gold reserves of France from $2.8 billion to $700 million and of the Netherlands from $1 billion to $200 million. France was the first country to borrow from the IMF on May 8th, 1947.

The modest credit facilities of the IMF were clearly insufficient to deal with Western Europe's huge balance of payments deficits during the 1940–1950s. France was the first nation to apply for loans from the World Bank on May 31st, 1946 and then the IMF. On March 1st, 1947, the IMF began its financial operations, and on May 8th, 1947 France became the first country to borrow from the IMF.


Ambassade de France
aux Etats Unis

Washington, le 31 mai 1946

714

Monsieur le Président,

J'ai l'honneur, au nom du Gouvernement Provisoire de la République Française, de présenter à la Banque Internationale pour la Reconstruction et le Développement la demande d'un emprunt à long terme d'un montant de 500 millions de dollars.

Je me tiens à votre disposition pour vous faire fournir, dès que vous le jugerez utile, les renseignements qui pourraient être nécessaires à la Banque./.

Veuillez agréer, Monsieur le Président, les assurances de ma haute considération.

H Bonnet

Ambassadeur de France

The Honorable Emilio G. Collado,
Temporary Chairman,
International Bank for Reconstruction and Development,
1818 H Street, N.W.
Washington, D.C.

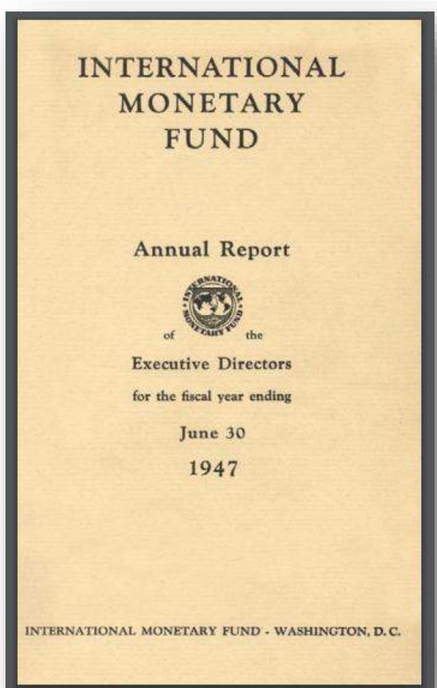
The French loan application for $500 million to the World Bank arrived as a simple letter attached to an outline of the government's reconstruction program, the Monnet Plan. The overall requirements included $106 million for equipment, $180 million for coal and petroleum products, and $214 million for raw materials.

The equipment included ships, freight cars, trucks, radio and electrical equipment, and coal mining equipment. The list of raw materials included fertilizers, copper, tin, synthetic rubber, animal fats and chemicals. The Bank agreed to half that amount, with the possibility of a second tranche. The relative amounts for each category in the overall requirements remained the same. The loan, the World Bank's first, was signed on May 9th, 1947.

The timing of the French loan was ideal for the World Bank to establish its credibility as a lender. It was just before the World Bank's first bond issue. France was expected to make good use of the dollars and was an acceptable credit risk. It was also understood within the World Bank that this loan would not set a precedent.

The French World Bank loan was not ***"for the purpose of specific projects of reconstruction or development,"*** as specified in the World Bank's Articles of Agreement, but was covered under the ***"special circumstances"*** provision. For many years to come, program loans such as this French reconstruction loan would remain as an exception given that the World Bank thereafter concentrated on project lending.

The problem was further aggravated by the reaffirmation by the IMF Board of Governors in the provision in the Bretton Woods Articles of Agreement that the IMF could make loans **only** for current account deficits and not for capital and reconstruction purposes. Only the United States contribution of $570 million was actually available for the world's largest development bank, International Bank for Reconstruction and Development (IBRD) provides financial products and policy advice to help countries reduce poverty and extend the benefits of IBRD lending.



Moreover, because the only available market for IBRD bonds was the conservative Wall Street banking market, the IBRD was forced to adopt a conservative lending policy, granting loans only when repayment was assured. Given these problems, by 1947 the IMF and the IBRD themselves were admitting that they could not deal with the international monetary system's economic problems.

Then in 1949, Britain was compelled to devalue the pound from $4.03 to $2.80. The next devaluation came in 1967 from $2.80 down to $2.40. Then the pound collapsed to par in 1985 to $1.03.

Bank Of England
£1 One Pound Note (1949-1955)

The United States set up the European Recovery Program (Marshall Plan) to provide large-scale financial and economic aid for rebuilding Europe predominantly through grants rather than loans. Countries belonging to the Soviet bloc, e.g., Poland were invited to receive the grants, but finally they were forced by Stalin to reject the aid. In a speech at Harvard University on June 5th, 1947, U.S. Secretary of State George Marshall stated:

> *The breakdown of the business structure of Europe during the war was complete. … Europe's requirements for the next three or four years of foreign food and other essential products … principally from the United States … are so much greater than her present ability to pay that she must have substantial help or face economic, social and political deterioration of a very grave character.*

—"Against Hunger, Poverty, Desperation and Chaos"[Notes 4]

There was a massive dollar shortage in the world given that the dollar had been made the reserve currency by the Bretton Woods Agreement. Between 1947 and 1958, the United State had deliberately encouraged an outflow of dollars in an effort to restart the world economy. The military spending abroad from 1950 onward, provided the liquidity for overseas economies. The United States ran a balance of payments deficit with the intent of providing liquidity for the international economy.

Japan postwar lost all confidence in the government because the military had seized and ruined the country. There was a huge divergence in the currency during the American occupation. The US military issued what was known as B-yen in Okinawa because they intended to occupy that region even after leaving Japan in general.

Therefore, B-yen of the US occupation of Okinawa Prefecture began following the end of World War II. The US military also used a separate scrip called A-yen, while the B-yen was only used by the local civilians. Post-1945 Japan became a currency-free system where the nation fell back to bartering supplies from the authorities just like in a prison. The reintroduction of currency with the B-yen was restricted to Okinawa whereas the introduction of the new Japanese yen emerged for the rest of Japan.

In 1948, the A-yen previously used exclusively by American soldiers ended and the B-yen came to be used by military and civilians alike. The rest of occupied Japan continued to use the new Japanese yen during the occupation.

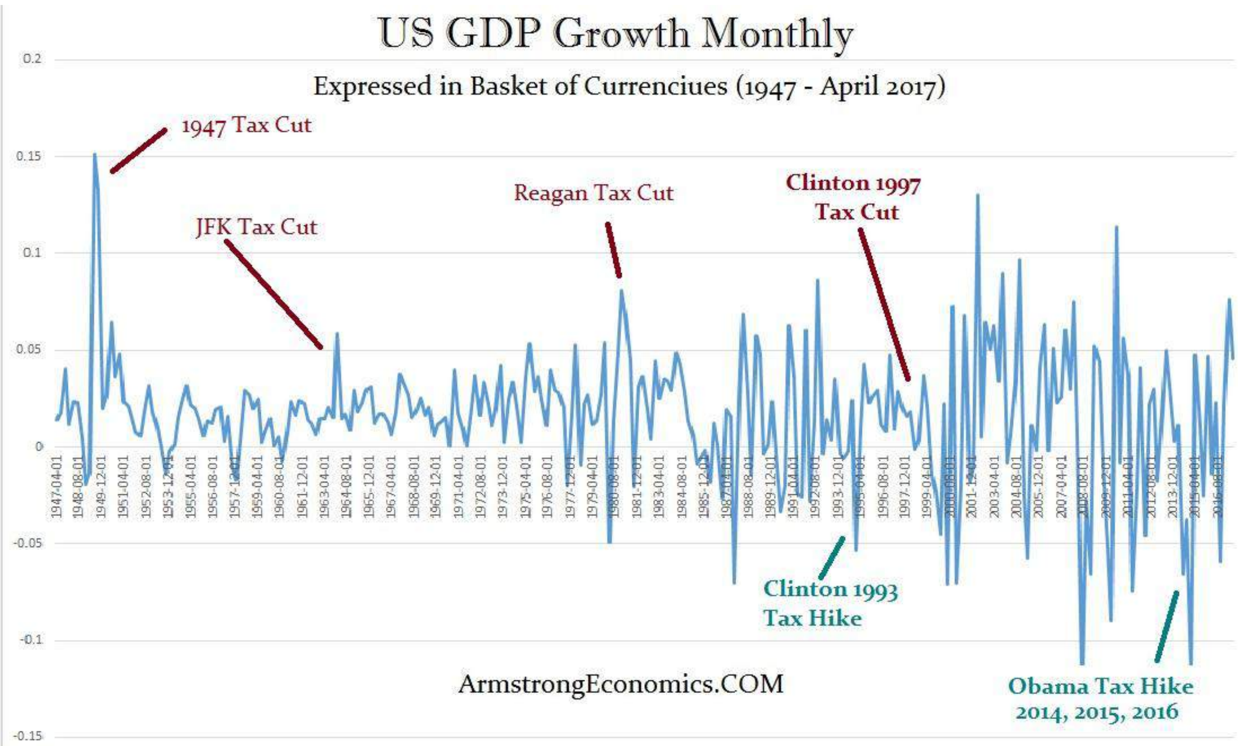
Eventually, the B-yen was eliminated in Okinawa on September 16, 1958, and was replaced by simply the US dollar at an exchange rate of 120 B-yen to the dollar. The Japanese yen was fixed at an official exchange rate of 360 yen to US$1.

1944 One Yen Note

The Japanese economy struggled until the Korean War. Japan received tremendous capital inflows from the United States to produce materials for the war. This is what finally resurrected the Japanese economy.

Indeed, dollars flowed out through military expenditures as well as various U.S. aid programs: the Truman Doctrine entailing aid to the pro–U.S. Greek and Turkish regimes, which were struggling to suppress communist revolution. Additionally, aid was provided to various pro–U.S. regimes in the Third World, and most important, the Marshall Plan. From 1948 to 1954 the United States provided 16 Western European countries $17 billion in grants.

To restart the world economy under the theory that this would build a consumer market for the United States to sell goods overseas may have been a nice dream, but the truth was the reverse unfolded. The United States did encourage long–term economic growth both in the European and Japanese trade competitiveness. Policies for economic controls on the defeated former Axis countries were scrapped. Aid to Europe and Japan was designed to rebuild productivity and export capacity.



Grover Cleveland (1837–1908)

> "When more of the people's sustenance is exacted through the form of taxation than is necessary to meet the just obligations of government and expenses of its economical administration, such exaction becomes ruthless extortion and a violation of the fundamental principles of a free government."

Second Annual Message of December 1886

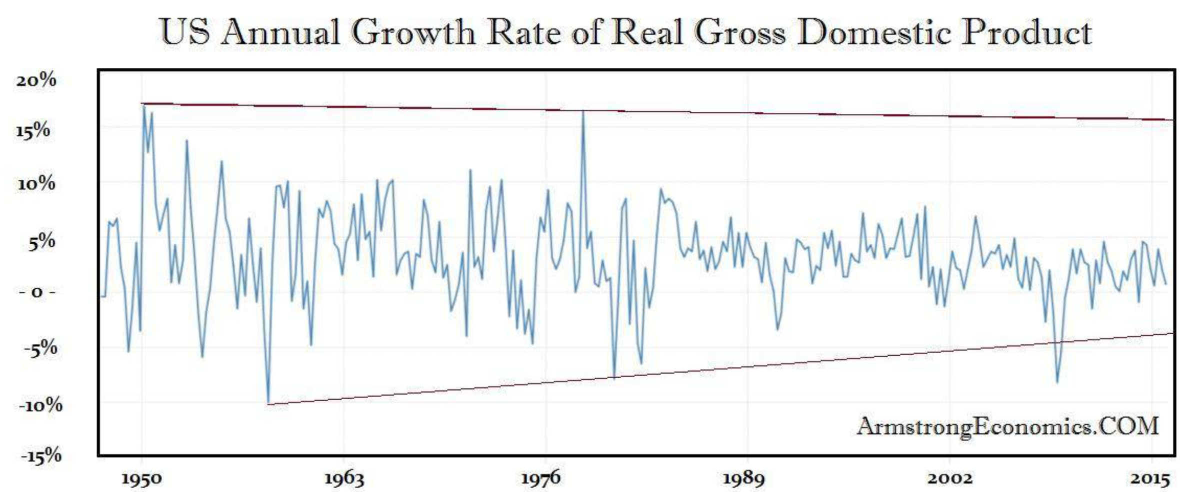
ArmstrongEconomics.COM

In the long run it was expected that such European and Japanese recovery would benefit the United States by widening markets for U.S. exports, and providing locations for U.S. capital expansion. But the socialism which took hold following World War II created a counter–trend which incentivized capital and industry to move off shore. To this day, if we allocate trade according to the flag flown by the entity, the United States has retained a trade surplus for much of the trade deficit is U.S. companies importing their products manufactured offshore. Taxes have been the greatest deterrent to economic growth.

Grover Cleveland (1837–1908)
only President of United States to serve two non consecutive terms (1885–1889 and 1893–1897)

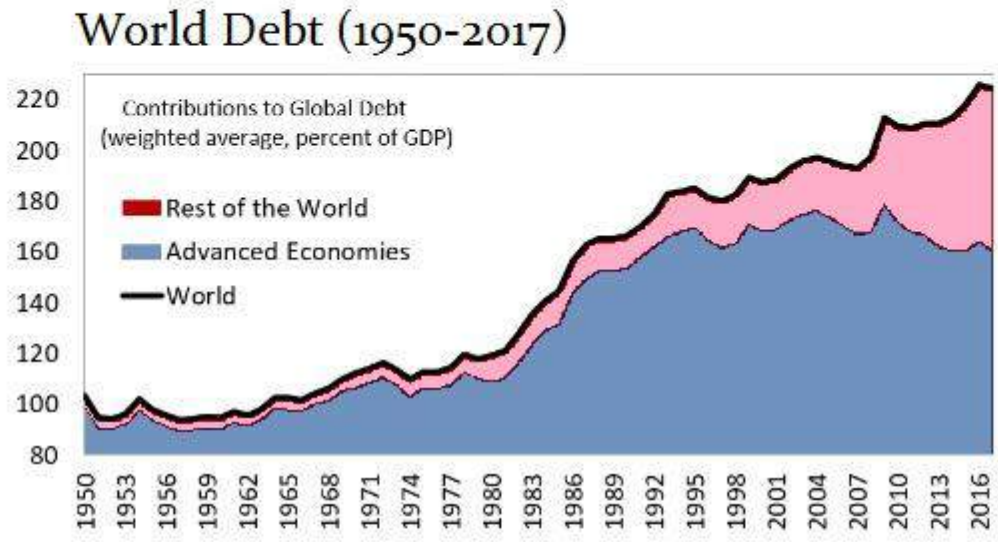
"At times like the present, when the evils of unsound finance threaten us, the speculator may anticipate a harvest gathered from the misfortune of others, the capitalist may protect himself by hoarding or may even find profit in the fluctuations of values; but the wage earner – the first to be injured by a depreciated currency – is practically defenseless. He relies for work upon the ventures of confident and contented capital. This failing him, his condition is without alleviation, for he can neither prey on the misfortunes of others nor hoard his labour."

President Grover Cleveland during the Panic of 1893 made a keen observation which to this day remains ignored by those in government. He warned that the capitalist could hoard money during times of uncertainty or even export it offshore to a safe haven. But the wage earner "can neither prey on the misfortunes of others nor hoard his labour." It is always the average person who is hit the hardest by the incompetence of government.

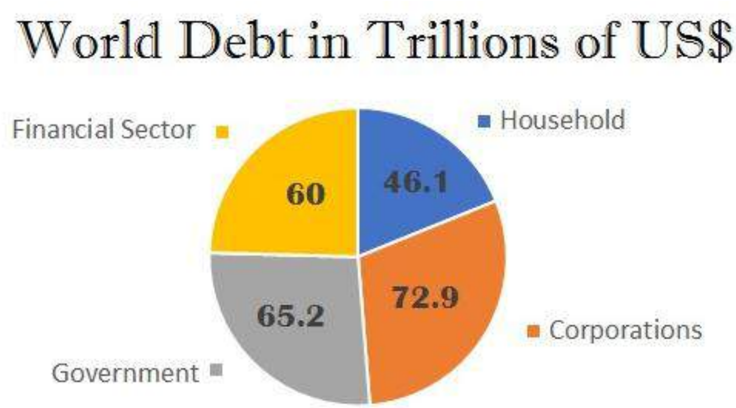


Source: Bureau of Economics Analysis

As taxes have risen and regulation expanded without limit, the economic growth has steadily declined from 1950. Each decline has been becoming progressively deeper and the rallies during boom times have always failed to exceed the previous peak.



We have returned to the period of the sever shortage of dollars in the eternal sea of world commerce. This may sound absurd when the US national debt has risen to exceed $20 trillion. However, global debt has reached an all-time high reaching $244 trillion in nominal terms, the equivalent of 320% percent of GDP in 2018. On average, the world's debt now exceeds $86,000 in per capita terms, which is more than 2½ times the average income per-capita. The US national debt is only in the area of 10-12% of world debt. It is in this context that we have a serious dollar shortage on a global scale as economic conditions turn negative in Europe and Asia.



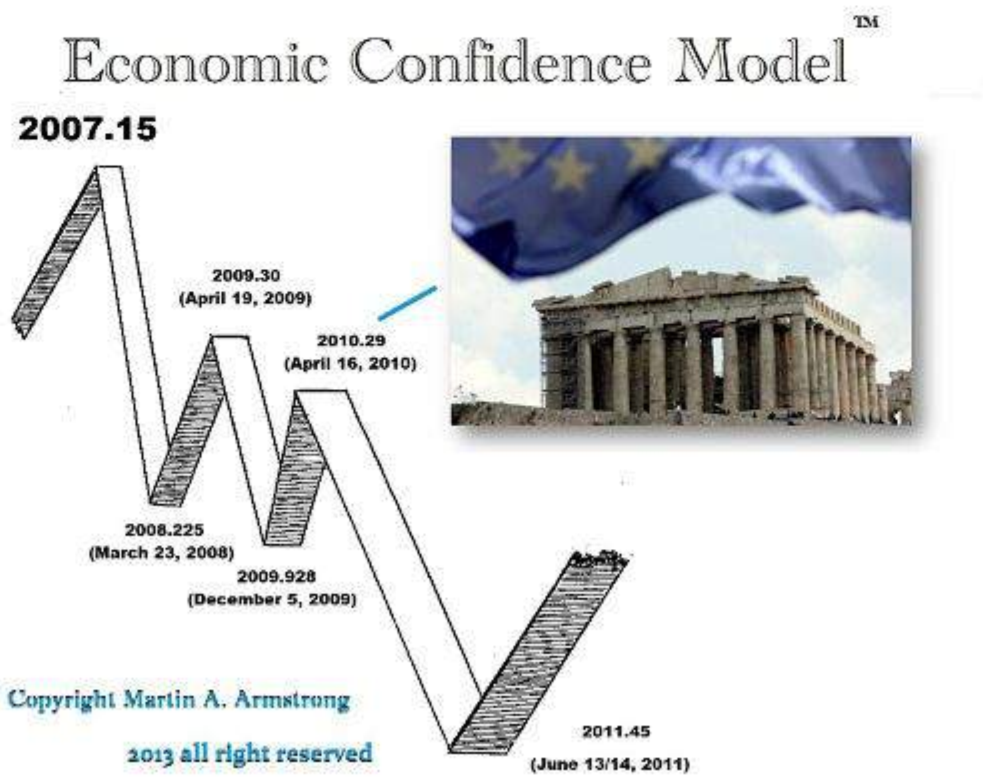
Welcome to the shortage of U.S. dollars that is not understood and remains hidden from view of particularly domestic analysts.

The Next Monetary Reform Bretton Woods II

In the wake of the Global financial crisis of 2008, there has been a rising consideration among some policymakers that a new international monetary system is going to be needed. I have stated before that among the many questions asked of me has been how do we end the reserve status of the dollar? It has become painfully obvious that the Federal Reserve is now the central bank of the world by default. This **Repo Crisis** boils down to banks no longer trust banks which further demonstrates that the shortage of dollars in Europe and the deep concerns about counterparty risk has compelled the Fed to engage not in **Quantitative Easing**, but emergency **Reverse Repos** injecting about $200 billion weekly into the financial system to **PREVENT** interest rates from rising dramatically.

There is little doubt that we will be forced to see what can be dubbed as Bretton Woods II. Indeed, even back during the 2008 meltdown, on September 26th, 2008, the French President Nicolas Sarkozy said, ***"we must rethink the financial system***

from scratch, as at Bretton Woods." Subsequently, about one year later at the September 2009 G20 conference in Pittsburgh, Pennsylvania, a realignment of currency exchange rates was even proposed. The idea was that deficit nations may devalue their currencies and surplus nations may revalue their currencies upward.



The stress in the world economy revealed during the 2007-2009 Crisis came to a head when Greece had to apply for an IMF Loan precisely on the April 16th, 2010 Pi Turning point on the **Economic Confidence Model**. Just weeks before, in March 2010, Prime Minister Papandreou of Greece wrote an op-ed in the International Herald Tribune, in which he said, ***"Democratic governments worldwide must establish a new global financial architecture, as bold in its own way as Bretton Woods, as bold as the creation of the European Community and European Monetary Union. And we need it fast."*** Prime Minister Papandreou told the world that his meeting with President Obama led to his promise to table the issue of new regulations for the international financial markets at the next G20 meeting that was due in June in Toronto and Seoul in November 2010.

The summit's priorities were intended to be focused on the progress of financial reform and the progress of developing sustainable stimulus measures. The slogan for the Seoul Summit was "Shared Growth Beyond Crisis." Yet no consensus was achieved and the focus really became on cooperation to hunt down tax avoidance on a global scale. While they claimed to seek promoting open markets, their interest in increasing tax enforcement was counter-productive to their stated goals of creating economic growth and recovery.

The Platform for Collaboration on Tax was a joint effort that was finally launched in April 2016 by the International Monetary Fund (IMF), the Organization for Economic Co-operation and Development (OECD), the United Nations (UN) and the World Bank Group (WBG). This combined effort was intended to hunt down tax havens and the IMF used the threat of blocking countries from the Swift system if they refused to cooperate. There emerged a tremendous momentum around international tax issues to hunt down offshore money. This was the initial proposal at the June 2010 Toronto G20 meeting. This was cheered by the G20 finance ministers at their February 2016 meeting in Shanghai.

Many leaders of the G20 in 2010 disagreed about which issues should be discussed at the summit. The primary focus of the summit was to be discussions concerning recovery and the European debt crisis which was only being acknowledge behind closed doors. There was no consensus reached with respect to which strategies would be best for tackling these problems.

The European Union emphasized the need to cut their deficits by focusing on austerity measures which were championed by Germany because of their prior experience with hyperinflation of the 1920s which they never understood. The United States experience during the Great Depression was precisely the opposite. It had been austerity which was far worse in the economic crisis. Therefore, the United States stressed the exact opposite policy with the importance of maintaining economic stimulus spending in order to encourage growth.

The European Union insisted upon austerity imposing reductions in spending and balanced budgets which was the disastrous policies of Herbert Hoover during the Great Depression. China, India, and the United States argued in favor of increased stimulus funding to mitigate the effects of recession against Europe. Hence, no consensus was reached at the G20 meetings.

It was the European Union that insisted upon the creation of the were a **Platform for Collaboration on Tax** and a **Robin Hood tax**, which was proposed by nearly a thousand socialist economists from 53 countries had written to G20 finance ministers urging them to tax City speculators to help the world's poor. They wanted to tax on transactions in financial markets as "an idea that has come of age". The **Robin Hood tax** was opposed by the United States and Canada further illustrating that no consensus could be achieved.

The inability of the G20 to come to any consensus even during the 2007–2009 Crisis remains the greatest obstacle to monetary reform. The European philosophy remains one of trying to create fixed exchange rates to mask the problems exposed by floating exchange rates relative to domestic pollical decisions. Moreover, the clash between the philosophy of austerity imposed upon Europe by Germany is complete opposite of the experience in the United States and Britain for that matter.

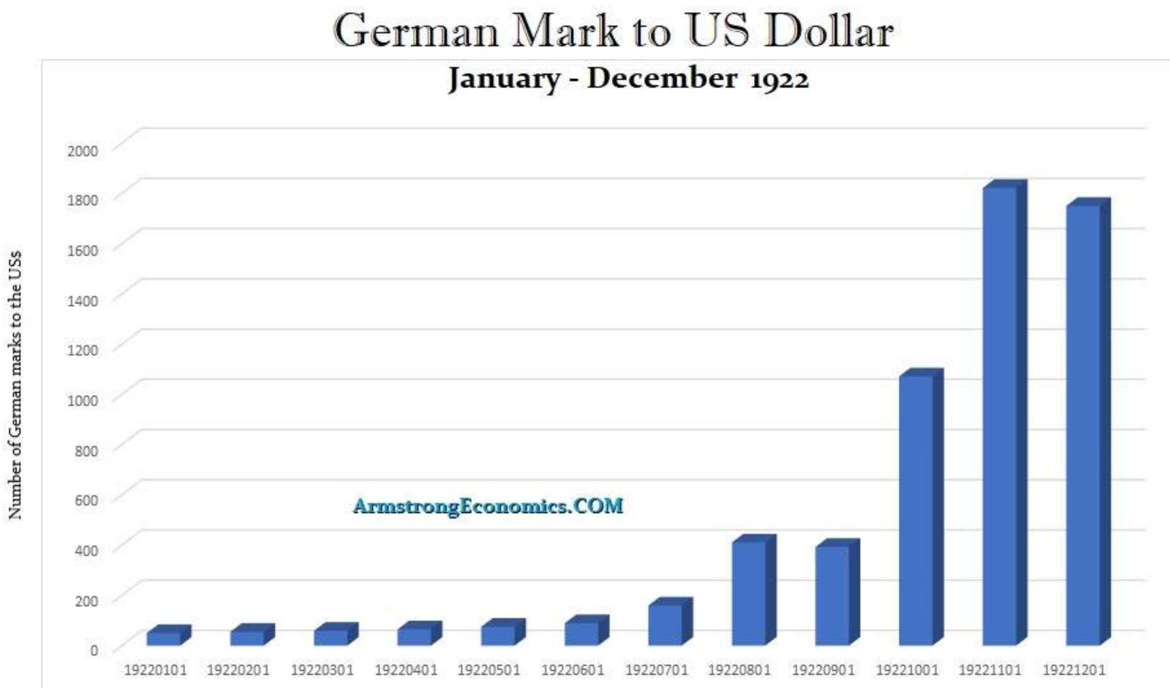
Because the Federal Reserve during the Great Depression practiced austerity and refused to increase the money supply, more than 200 cities began issuing their own money called Depression Scrip. The shortage of dollars exacerbated the Great Depression suppressing economic growth due to austerity.

The German Forced Loan of December 1st, 1922
Schuldverfchreibung (Debenture Bond)
ArmstrongEconomics.COM

The German people were forced, through the **Treaty of Versailles**, to make reparation payments amounting to approximately three times the value of all German property. This was the source of the German Hyperinflation. It was not the creation of money which resulted in the hyperinflation, but the combination of a complete collapse in confidence sparked by (1) the communist revolution which created the Weimar Republic, and (2) Germany resorted to forced loans imposed upon their own people.

In November 1922, when Germany was unable to make its reparations payment as scheduled, the Weimar Republic found it was unable to finance itself to meet the Reparation payments. Then President Ebert turned to forced loans compelling German citizens to buy government bonds. All people with any wealth greater than 100,000 Marks were obligated to provide finance of up to 10% of the value of their assets. The loan did not bear any interest whatsoever until 1925. After the hyperinflation, between 1925 and 1930 the forced loans bore 4% interest and from 1930 onward this was raised to 5%. Piles of these bonds remain today – worthless beyond merely a collector's value.

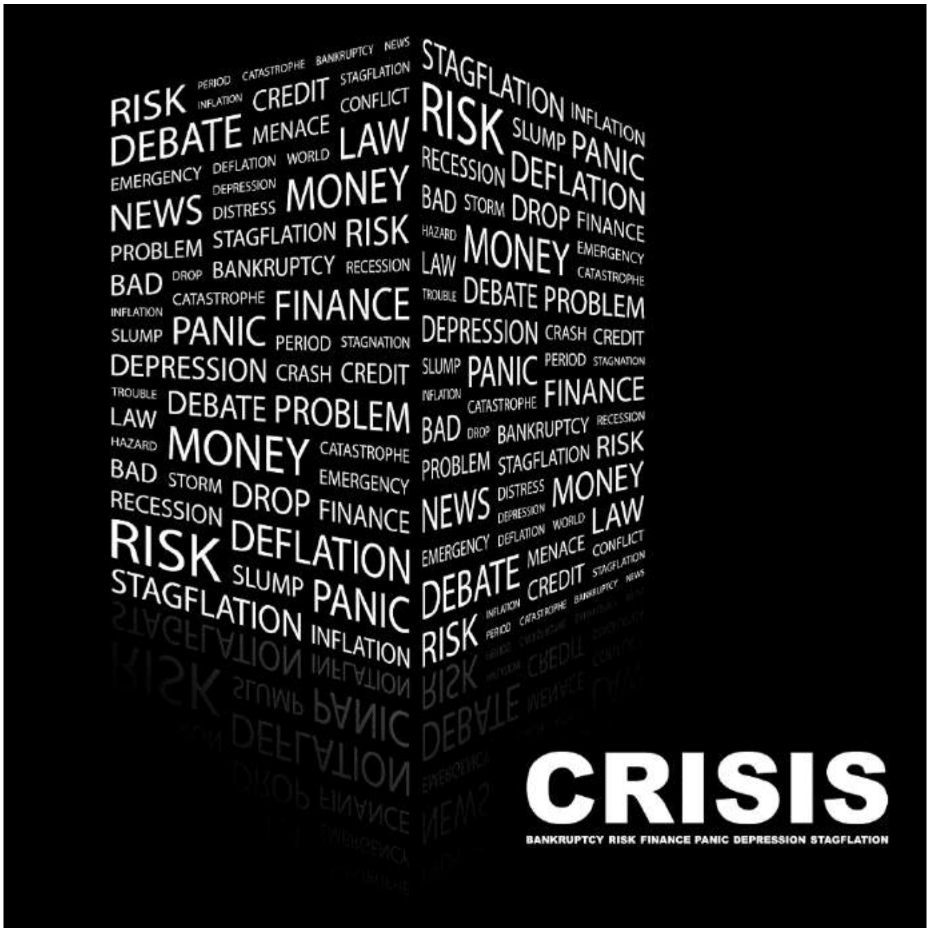
The German interpretation of inflation was exactly opposite of how it took place. They assumed that hyperinflation was caused by the government just printing money. The truth was that the government was unable to borrow and tax to meet the reparation payments and the more punitive they became the worse the economy declines. This in turn forced the government to print more money to meet its expenses.



When we look at the hyperinflation data, we can easily see that the German mark began to collapse in October 1922, but it capitulated during November 1922. It was more than the simple analysis that people always apply to the hyperinflation attributing the cause to merely printing money and impossible terms from the **Treaty of Versailles.**

The December 1st, 1922 degree of forced loans of 10% of your total net worth to the government to meet Reparation Payments was a devastating blow. From that moment on, capital simply fled the country by any means possible. The "rich" would no longer invest helping the economy recover. This single act truly sparked the German Hyperinflation. This is what even allowed the forced loan to take place whereby no political party would have to admit to this action. The value of the German currency collapsed clearly being propelled by the forced loans. The invasion of the Ruhr merely added to the demise of the German mark.

Government always assumed they can simply raise taxes and people will pay. They ignore human nature which will seek to protect itself and even flee the country if necessary. Investment stops and wealth no longer supports the economy and job creation.



There is little doubt that we will be forced into a Bretton Woods II. However, the prospect of this unfolding in a reasonable manner is in the same position of interest rates in Europe – zero to negative. The entire philosophy behind the creation of the Euro was to create a fixed exchange rate system by adopting a single currency. But this is also why Germany agreed to join only if there would be no consolidation of debts. Thus, it was a fixed exchange rate they sought rather than a true European integrated economy.

As the shortage in dollars escalated, the impact on the U.S. trade deficit will increase pushed higher by the dollar rally. Every time the dollar rallies, that is when we get the monetary crisis and reforms. The dollar rally into the 1930s forced Roosevelt to devalue the dollar and confiscate gold in 1934. When the dollar rose dramatically in 1985, that resulted in creating the Plaza Accord with the objective of manipulating the dollar lower and the proposition to create the Euro.

While it would be nice to think that our world leaders will come together and do the right thing, but the prospect of that happening is again zero to negative. We will most likely see pressure to replace the dollar are the reserve currency. The IMF has been pushing for their SDR to replace the dollar for some time now. The United States will want to free the Federal Reserve where its domestic policy objectives are being overrun by international policy. The Repo Crisis is demonstrating that with the collapse in general confidence with counterparty risk rising, the Fed cannot simply fund the entire world. As pointed out, the U.S. National debt is only about 10% of world debt. The Fed cannot hold back the brewing global debt crisis which has been accelerated by the increase in the hunt for taxes.

INTERNATIONAL MONETARY FUND

March 6, 2018

CONSIDERATIONS ON THE ROLE OF THE SDR

EXECUTIVE SUMMARY

This paper explores whether a broader role for the SDR could contribute to the smooth functioning and stability of the international monetary system (IMS). Recent staff assessments highlighted that the IMS has displayed considerable resilience. But episodes of stress point also to some weaknesses, including in external adjustment mechanisms; limitations of official liquidity provisions through the Global Financial Safety Net (GFSN); and large-scale reserve accumulation—with systemic side effects. Those weaknesses, together with the expansion of the SDR basket, have renewed interest in the SDR and motivated a discussion of whether there is an economic rationale for a broader SDR role. The paper looks into how those weaknesses can be mitigated by three concepts of the SDR: the official SDR, the reserve asset administered by the IMF (O-SDR); SDR-denominated financial instruments, or "market SDRs" (M-SDR); and the SDR as a unit of account (U-SDR). However, the paper does not propose specific reform options.

While the O-SDR currently plays a limited role in contributing to the smooth functioning of the IMS, it could potentially have the greatest scope under a different legal framework. O-SDR allocations could buffer external adjustment, and help reduce precautionary reserve accumulation, although the current Articles of Agreement (AoAs) would need to be revised to address important challenges around scale, targeting and use of O-SDR allocations. And while O-SDRs could provide a flexible source of finance to bolster the Fund's lending capacity, for example to respond to large-scale events, changes to the allocation mechanism and options to create O-SDRs outside of the current allocation process to help address gaps in the Fund's lending capacity would again require amendments to the AoAs. The findings are in line with work conducted in 2011, which concluded that the O-SDR could potentially have a more promising role in aiding the IMS but faces challenges.

Widespread M-SDR and U-SDR use would likely make more limited contributions to systemic stability, and face significant implementation challenges. Diversification properties of the M-SDR and U-SDR could lower valuation changes for the balance sheets of some borrowers and investors. This may reduce the risks of sharp external adjustment and potentially reduce precautionary reserve demand. Systemic benefits of the M-SDR would only come with deep, liquid markets, which may be difficult to generate. Nevertheless, use of M-SDRs and U-SDRs could be mutually re-enforcing, exploiting potential complementarities. A supportive environment based on

INTERNATIONAL MONETARY FUND 1

official support could help generate network externalities, attracting a sizeable share of transactions. But the impact of any shift in use could also be limited, for instance, by the high correspondence between SDR basket weights and the existing share of currencies in international transactions, and by the ability of many investors to better customize, compared with the SDR, their currency exposures at low cost.

Economic and technological developments will affect the future shape of the IMS, and might affect the SDR's role. The prospect of a more multipolar global economy could exacerbate uncertainties over how international currency usage will evolve, and increase systemic risks around international liquidity and its provision. Further work is needed on how financial technologies (fintech) could impact the IMS and currency usage. For instance, Distributed Ledger Technologies (DLTs) could boost interconnectedness and amplify susceptibility to spillovers and capital flow volatility while influencing the attractiveness of a reserve currency. Such an environment might call for a re-evaluation of the role of the SDR.

Both China and Russia object to the dollar being the reserve currency. They would most certainly support a new monetary system with something other than the dollar forming the central pillar of the world monetary system. Whether they would agree to the IMF remains an open question. Russia has been setting up its own SWIFT system and China's banking system and regulations are not compatible with those of the West.

The ideal and proper reform would be to have a central clearing reserve currency with each nation maintaining its own currency which would then **FLOAT** against the central reserve. It would be critical to allow all currencies to **FLOAT** for that would end the allegations of currency manipulation as has taken place alleged by the United States v China.

It is clearly the dollar shortage in Europe with the stark contrast between the balance sheet of the Federal Reserve v the European Central Bank. It is this dollar shortage manifesting in the Repo Crisis which will put the most pressure upon the governments and compel the United States to seek some sort of reform.

Prior to World War I when the world was on a gold standard, the central banks of Europe were faced with two duties:

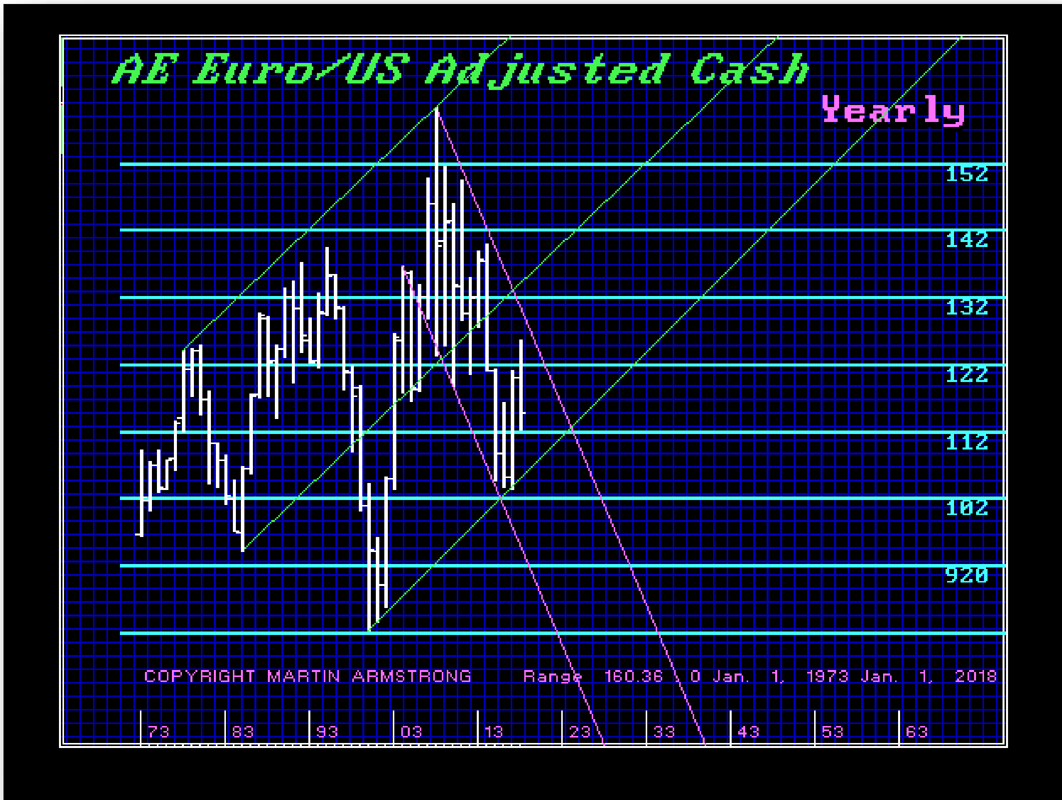
1.) The first was to defend their currency's parity with gold and thereby the entire edifice of the international gold standard. This required raising interest rates and keeping the total volume of money and credit under control, often with contractionary effects.

2.) The second responsibility was to act as a lender of last resort for their banking system by supplying emergency liquidity. This necessitated an expansion of credit and a lowering of interest rates.

Post–1971, the central banks were no longer required to intervene to maintain the exchange rate of the currency relative to the gold standard. The floating exchange rate relieved the central banks of the duty to manage the currency. However, the post–1971 era became the primary focus of Keynesian Economics with the duty shifting to control inflation.

Paul Volcker raised interest rates insanely into 1981 to stop inflation, but he ignored the consequences that would have on the value of the dollar on world markets. This was the stone that hit the standing pool of water which then at the **1985 Plaza Accord** suggested that Europe create a single currency. One mistake is never corrected and never acknowledged. They constantly create a new scheme to solve the last one they created.

Therefore, I see little hope that we will witness this new monetary reform actually solve the crisis we have brewing globally. Governments will only continue to seek to enforce tax collections and they will look to try to fix currencies so they do not have to actually reform their policies. The shortage in dollars is more likely than not simply going to accelerate the process leading into a crisis as we approach 2021–2022.



With the crisis in the Repo Market emerging from a shortage of dollars concentrated in Europe, we see 2020 as a **Panic Cycle** and a **Directional Change** Year warning that the FOREX markets can get extremely volatile next year. With the **Economic Confidence Model** coming to a major shift with the start of a new 8.6-year wave come January 18/19, 2020, we have to understand that while a normal cycle would call for the dollar to decline for up to 2 years into 2021, that is where the crisis appears to be set to begin. However, we need to see a closing at year-end above 11620 in the Euro to confirm a rally against the dollar due to central bank manipulation. Nonetheless, the major resistance will remain at the 12050-12100 level preventing any true change in trend long-term.

Therefore, the possibility of a 2-year reaction before the complete chaos unfolds remains viable. However, a closing for 2019 between 11215 in the Euro will warn that this can meltdown drastically and bottom in 2021 forcing serious political change. The market will reveal its decision at year end 2019.