

# Honest Money Gold & Silver Report

## The Brave New World Economy *A Rejoinder to Mohamed El-Erian*



"The woman whom you saw is the great city,  
which reigns over the kings of the earth." <sup>[1]</sup>

"For all the nations have drunk of the wine of her impure passion,  
the kings of the earth committed fornication with her,  
and the merchants of the earth grew rich from the abundance of her luxury." <sup>[2]</sup>

### Introduction

This is the second article in a series of three papers, which collectively comprise the complete rejoinder to Mr. Mohamed El-Erian's article: [Complex Finance and the Brave New World Economy](#).

The same format used in the first paper will be utilized again. The article will be broken down into paragraphs, followed by a synopsis of the main points of each paragraph, and then comments. This focus on each individual paragraph separately facilitates an easier understanding and discussion of the complex issues involved.

Once again I would like to emphasize that this rejoinder is to what was said – not to who said it. Mr. El-Erian is a great scholar recognized and respected around the world. This is not personal, it is simply business.

### PARAGRAPH SIX

The interaction of these economic and technical changes has altered market valuations, volatility, velocity and liquidity. No wonder various markets seem to be sending conflicting signals. No wonder market participants are having trouble predicting central bank policies, which are becoming more tentative. No wonder economists cannot resolve debates on the outlook for global payments imbalances. <sup>[3]</sup>

The main points made are:

- The interaction of these economic and technical changes has altered market:

1. Valuations

2. Volatility
3. Velocity
4. Liquidity

- Thus markets are sending conflicting signals
- Market participants are having trouble predicting central bank policies, which are becoming more tentative
- Economists cannot resolve debates on the outlook for global payments imbalances

### **Comments:**

Mr. El-Erian posits that four aspects or segments of the market have been altered by the interaction of the economic and technical changes transpiring (according to his analysis) on the global stage.

### **Valuations**

First on his list are valuations. Value is in the eyes of the beholder, or as Carl Menger and Ludwig von Mises said: valuation is a subjective phenomenon. What one man values as riches, another man values as junk.

Take water for example. Water is valued by all, as it is a basic element needed for human survival. All people, animals, and crops require water to sustain life. Without water there would be no life. Does this mean that all human beings value water the same? No it does not.

For a man stranded in the Gobi Desert without water, water becomes of great value. If he does not acquire it very quickly he will die. Water will be at the top of his list of values.

Compare the man stranded in the desert with another man who lives high in the Alps. He lives next to a lake of fresh mountain water. There are very few people living in the area. He values water, as he too needs it to sustain life.

But his supply of water is far above and beyond his demand for water. He can never consume the supply of water within the lake. He has a surplus of water, while the man in the desert has a deficit of water.

The man in the Alps would gladly accept \$1 dollar per gallon of water from any hikers that pass by his home and want a drink of water or some for cooking. The man in the desert would gladly pay \$1000 dollars for a gallon of water – perhaps much more.

Because the supply and demand factors are vastly different in the two examples, the two men value the water differently and accordingly. Value is seen to be quite subjective.

So what is it that is altering the valuation within the markets that Mr. El-Erian speaks of? All value is based on need: the importance one places on any given commodity or service to fulfill a need the person has: be it food, water, clothing, shelter, heat or any other such desire.

Commodities are valued according to their utility to fulfill a particular need that a market participant has. This is the theory of marginal utility. The market dynamics of the law of supply and demand weigh heavily in the balance, as the example above regarding water shows.

Getting back to the alteration of today's market valuations, we can now discern what dynamics are at play. Obviously, the law of supply and demand looms large in the equation. So too does subjective value and marginal utility.

With the advent of indirect exchange within the marketplace, where barter no longer rules the roost, money is the preferred and most commonly accepted medium of exchange. Now the supply and demand for money is part of the equation of subjective valuation. On the other side of the equation is the supply and demand for whatever goods or services are being considered for procurement.

If an individual is auctioning off his used car, and the largest amount of money that any of the bidders in the crowd has is \$5000 dollars – the owner of the used car is not going to receive more than that amount for his car, unless a bidder offers a higher price based on credit or additional money he will obtain and pay to the owner of the car.

The same would hold true if the largest amount of money in the "economy of the auction" was \$3000 or \$1000. The greater the supply of money there is amongst the bidders – the higher will be the price the owner of the car may receive.

Likewise is the supply and demand for the car. If there were one hundred cars about to be auctioned off, then there are plenty of cars to fulfill the demand of the participants at the auction.

However, consider the instance where only one car is being sold at auction. The supply of cars in town is low and the demand for cars is high. The closest town with a large commercial base of jobs is fifty miles away. There are no buses or trains. Cars are needed to commute to work. You can bet your bottom dollar that the lack of supply will play heavy on the price the used cars fetch.

Price is but the quantification of all market participant's subjective valuations: based on need and the marginal utility of the good to fulfill that need (demand), compared to the supply of the good.

The ratio of the supply and demand for the good, is then compared to the ratio of the supply and demand for money. The resulting ratio is the price of the good: the quantity of units of the common medium of exchange needed to procure the item in question.

Money is valued by all market participants, as it is the common medium of exchange by which all goods and services within the marketplace change hands: from sellers to buyers. When one buys a good they are "selling" their money. When one sells a good they are "buying" money.

Thus price formation is had by comparing the value of the good to the value of the money to procure the good. The number or ratio of the units of exchange needed to exchange for the good is the price of the good.

From this we can see that any alteration in market valuations must be based on and due to the supply and demand of the goods and services that make up the market, as well as the supply and demand for money that is used to exchange and procure all goods and services with. When either side of the equation is out of whack with the other, it will distort the market dynamics and greatly alter the process of price formation.

Consequently, when one says that market valuations have been altered such that the alteration is sending CONFLICTING signals to the market participants, and confusing them as to what central bank policies and actions will be in response, let alone the position of the expert economists who can no longer provide a solution for the imbalance of global payments; and one can easily see the problems looming over and within the markets.

I would be remiss not to add that conflicting signals sound like they would be competing with one another. Perhaps the themes mentioned at the beginning of the article are not competing, although that is debatable, however, the effectual results of the themes, as they play out in the marketplace, are producing conflicting and competing signals – of that there is no question.

Also, perhaps debating such theme's merits is useless, but then why should it be of concern if economists cannot resolve debates on the outlook for global payments imbalances?

Furthermore, why only be concerned with the recalibration of the perspective employed to move forward, while accepting that these themes have produced structural changes within the marketplace?

If the changes being produced are sending conflicting signals and causing confusion, then the cause that is manifesting these various problematic results needs to be addressed and fixed or eliminated. Otherwise, it is simply another case of treating the symptoms of the disease, which may produce some fleeting relief or comfort, when what is truly needed is a sustainable and lasting cure for the disease, not a quick fix.

According to Jean-Claude Trichet, President of the European Central Bank, the following remarks he made from Davos show that he not only agrees with Mr. El-Erian's contention that market participants are having trouble in predicting the actions of central bank policies, but that the central bankers themselves are dazed and confused by the new proliferation of derivatives and their UNKNOWN consequences.

Prepare for Asset Repricing  
As reported by Gillian Tett in Davos

"The recent explosion of structured financial products and derivatives have made it more difficult for regulators and investors to judge the current risks in the financial system.

We are currently seeing elements in global financial markets which are not necessarily stable ... low level of rates, spreads and risk premiums are factors that could trigger a repricing.

There is now such creativity of new and very sophisticated financial instruments that we don't know fully where the risks are located. We are trying to understand what is going on - but it is a big, big challenge." [4]

There will be more said on valuations later on, for now this will suffice.

## **Volatility**

Volatility is another market dynamic that is being affected by the themes of global finance, as the participants play out the hands dealt them. The dealer is a powerful man, as he deals out the cards that forge the hands to be played. The house he works for is of even greater power, as is he who owns the house. He whose altar the owner of the house worships at is the top dog of this particular pack – much like the temple priests of the old Babylonian Brotherhood. Predict an eclipse or two, and you were a god amongst mere mortals.

Volatility is the measurement of changing valuations – how far and how fast they go first one way and then the other. It is similar to a puppy on a choke chain – first pulled this way and then the other. Needless to say the puppy is not happy, can you blame him, after all - he is on a choke chain.

Changing valuations result in changing prices. Changing prices result in changing profits and losses. Such is today's marketplace. The easier it looks – the harder it hooks. There ain't no

such thing as easy money. Come to think of it – in today's New World Order there might not even be any money that's real, except for gold and silver coin that is – Honest Money.

Certain participants at last week's meeting in Davos were of the opinion that the growth of the \$450 Trillion derivatives market has helped reduce market volatility by spreading credit risk. It should be remembered, however, that this is no different than a bookie laying off risk. The risk still remains – its just been dropped off onto someone else's lap, as a sort of present. A present whose presence will be fully presented in due time.

As with all things however, there were others with a different opinion. There were those who thought that the costs of borrowing credit at such low levels as 0.25% in Japan was similar to a pusher giving free dope to users to get them hooked, thereby creating a future income stream for life. Some refer to it as the Yen carry trade, spun tight like a spinning top - just before it starts to unwind.

Others expressed concern that raising leverage and risk taking to such elevated levels was simply increasing the probability of future financial crises. As chaos theory states: everything is just fine until it isn't – and then it's too late.

## **Velocity**

Velocity in general refers to the speed of an object, how fast it travels a given distance. The greater the velocity the faster the speed. The lesser the velocity the slower the speed. Irving Fisher elaborated on the concept and has been given the infamous distinction of being the father of the theory of the velocity of money.

Yes that's right – infamous, not famous. The velocity of money is one of several constructs of the quantity theory of money, which is an invalid and faulty monetary system that has done much more harm than good in the overall understanding of monetary theory; and even greater harm in its implementation as the curse of paper fiat debt-money that now holds the entire world in its sinister clutches.

The quantity theory of money has been peddled to the people by the hired guns or intelligentsia of the elite money changers. They would have you believe in such nonsense, so that you buy into their system of paper fiat debt-money, which is nothing but a transfer of wealth mechanism, used to siphon wealth from the people, to the elite collectivists in charge of the monetary system.

They would have you believe that to borrow and to go into debt is the way – but it is not, it only makes them wealthier and the common man poorer. Take the system of buying your home via a mortgage. The word mortgage comes from the root morte, which means death in French. Mortgage literally translates as a death gauge. Think about it – long and hard.

Things are NOT as they so would have you believe. No different from the Babylonian temple priests who ruled the people by misguided and false beliefs: illusion and delusion.

There are too many complexities in the velocity of money and the quantity theory of money to fully detail in the present work. I will name some of the basics and refer to other papers that cover the issues in much greater detail than can be had here and now.

The velocity of money is the number of times an individual unit of currency turns over (i.e., is spent) in a specific period of time. The theory espouses the idea that the faster or more often any given unit of currency is turned over or used, the greater is the economic activity that results therefrom. The velocity of money is the faster pace of the circulation of money.

The quantity theory of money stresses the importance of the number of units of money (supply) circulating within the economy at any given time. One of the basic tenets of the quantity theory of money is that the greater the number of units of money one has, the greater will be one's wealth, as they will be able to purchase more goods and services.

At first blush this may sound true, however, let's dig a little deeper. Money is only good for one thing: to use as a medium of exchange for other goods and services. So what is crucial for money is its PURCHASING POWER: the amount of goods that a monetary unit can be exchanged for.

The purchasing power of money is the quantity theory of money. It is not the number (quantity) of units of money that is most important to your wealth – it is the purchasing power of the money – what it can be exchanged for in the marketplace.

The more goods that can be had the greater the purchasing power – the greater is the resulting wealth. If all other things stay constant – the greater the supply of money, the less is its purchasing power.

However, there are in several other very important components, as we saw earlier. It is the supply and demand of money in relation to the supply and demand for goods and services that determines "price".

Also, money is not that big of a deal anymore in today's Brave New World: credit is now the name of the game. In today's New World Order, money is debt and debt is money. Money is created out of thin air by the extension of credit. Money, credit, and debt have morphed into one and the same thing: the unholy alliance.

In other words, the velocity of money (if such exists), is a minor player in today's paper fiat debt-money-credit system. The extension of credit plays an even larger role than does money in circulation. The velocity of money (if it exists) is a minor subplot to a much greater play: the quantity theory of money.

Furthermore, the quantity theory of money has now been surpassed by the quantity theory of credit, as the driver of the paper fiat debt-money-credit system. The faulty quantity theory of both money and credit is at the center of the many problems in today's global monetary, economic, and financial systems.

Money is the basis of the system, if the foundation is unsound, the structure built thereon, is unsound as well. It is but a house of cards – and the sisters of fate are blowing in the wind: destiny's child returning home.

## **Liquidity**

To understand liquidity we are going to look at the definition of the word itself. Note the word liquid is within the word liquidity. Now, what does liquid have to do with money? Think of liquid as water – water is a liquid, which flows through streams and rivers that creates a current or movement of the liquid water supply. The word currency is derived from the same root as the word current.

Liquidity refers to monetary vehicles that can be used or spent immediately in exchange for other goods and services. Cash is the currency in circulation. Cash is the most liquid of all forms of money and money substitutes or fiduciary money. Other forms of money are considered liquid if they can be easily and readily exchanged for money.

On the other side are vehicles that are not readily or easily turned into cash – things such as land or buildings or businesses. These assets must first be sold, which can take weeks to months to transact before they are turned into or exchanged for liquid cash.

How does the market or economy provide SOUND liquidity? – by labor or work, which produces goods and services within the economy. Over time, prudent market participants will accumulate their excess production and resulting income as savings, and invest the savings in both liquid and less liquid assets.

Sound capital investment comes from curtailed consumption that is put off by the saving (as opposed to spending) of excess income, which is then invested to produce future income.

But there is also another source of liquidity and capital formation, one that is not as sound as income and savings: it is called debt or credit. There is nothing wrong with sound credit and debt being extended as loans properly collateralized and properly extended.

Which means NOT by fractional reserve lending of money that is created by the very act of lending – money that did not and does not exist; and was never earned as income nor saved. This is unsound monetary policy that creates untold miseries for the people that accept it – and untold profits for those who create and issue it.

Malcolm Knight, managing director of the Bank for International Settlements had this to say on the subject:

“Financial innovation has produced vehicles for leverage which are very hard to measure . . . liquidity is increasing very rapidly and this is affecting asset prices.” [5]

There will be more on this topic. For now we move on.

### **Market Problems With Central Bank Policies**

We have already seen some examples above of the problems the proliferation of debt derivatives is causing. Not only are market participants confused by the excessive issuance of debt, central bankers themselves are at a loss in understanding how it works. This is especially true of unknown situations that are not readily quantifiable.

As Stanley Fisher, Governor of Israel's Central Bank questioned:

“Who takes responsibility for the [financial] system during a crisis situation, especially now that the hegemony of the US is diminishing?” [6]

Both Robert E. Rubin and former Federal Reserve Chairman Paul Volcker have warned of the possibility of coming crisis, as well they should, as they both have contributed to the root causes of systemic risk of excess credit that is now coming to fruition.

Volcker said:

“The U.S. borrowing requirements raise the risk of a crisis in the dollar as soon as the next two and a half years.” [7]

While Rubin added:

“It seems almost inconceivable that this will continue indefinitely.” [8]

### **Economists Debate Global Payment Imbalances**

As well they should. To think that the present excessive global payment imbalances are just part of the New World Order and should be accepted as part of the structural change of the system, and then be dealt with by recalibrating the way forward is naïve at best, and at worst shows a complete lack of understanding and or denial of the actual cause of such imbalances. It is tough to fix a problem if one does not know what the problem is, or is unwilling to acknowledge the true cause of the problem. Some call it denial.

Global trade imbalances remain at unprecedented levels. The U.S. current account deficit is expected to be almost 7% of GDP by the end of 2007. For 2006 the trade deficit was \$765 billion.

Japan & Germany had a cumulative trade surplus of over \$275 billion. China has the largest trade surplus with the U.S., and the largest currency reserves at over \$1 Trillion dollars. From 2001 until 2004 the U.S. deficit with China increased 95%.

Total global debt issuance in 2006 was \$7 trillion. The U.S. portion of the total was \$4 trillion. That leaves the rest of the world's debt issuance for last year at \$3 trillion. The U.S. gross domestic product was \$12 trillion, which equates with the U.S. borrowing 33% of the value of its GDP, and 57% of the total world debt issuance for 2006. Thus the debt to equity ratio was about 3 to 1.

That is poor fiscal and monetary mismanagement and cannot be sustained. It also means that if we did not borrow the \$4 trillion, then the economy would have been \$8 trillion instead of \$12 trillion. Think about it – long and hard. Then vote accordingly.

The world's gross product is approximately \$55 trillion, with the U.S. accounting for 22% of the total. World debt increased 14% from the year before (2005), yet the world GDP did not increase by that rate, which means debt is accumulating faster than wealth – and that's if one accepts that growth in GDP is the same as wealth accumulation.

I don't believe it is, as will shortly be shown. The U.S. share of the debt expansion increased 10%, but our GDP did not - once again signaling a loss of wealth. There may be growth – but **At What Cost And Paid By Whom?**

Gross domestic product may be growing, however, **debt is growing faster**. This is a prescription for a declining standard of living that is on the road to perdition, not on the road to prosperity – the so-called American dream. It is all smoke and mirrors – reflections of illusion and delusion.

According to conventional economic theory, consumer spending accounts for approximately  $\frac{3}{4}$ 's of the gross domestic product. Consumer spending has been on a steady increase, yet the savings rate has been on a steady decline – a decline that for almost 2 years running has registered NEGATIVE savings rates of up to -1.6%. That is a national disgrace.

Incomes have been on a rise, however, consumer spending has increased more. Where is the money coming from to make up for the difference between spending levels that are higher than income levels? Ah yes, it is that lovely four-letter word: DEBT. The consumer has been able to keep spending because they have gone deeper and deeper into debt.

Furthermore, just what does gross domestic product really measure? Notice how conventional economic analysis says that approximately 75% of GDP is **consumer spending**.

So the GDP is a measure of spending or **consumption**, not of production, or savings, or **real wealth accumulation**.

The economy is said to be growing or expanding, but what is really expanding is over consumption that is being fed by increased debt levels, which in turn results in negative savings rates. This is not wealth accumulation. This is death by debt. It forces one into a life of debt servitude. It prostitutes our children's futures to a life of working to pay the man.

The economy is nothing more than a ponzi scheme of wealth transference. The average worker is borrowing money to maintain their consumption and debt service.

Banks are lending money that they do not have. The money is created on the spot by the very act of extending credit; and the extension of credit means increased debt and increased debt service (interest payments). This is NOT wealth creation no matter what they tell you. Do not be deceived. Do not accept the unacceptable. And it gets even worse.

## Seventh Paragraph

No wonder there is a sense that greater international co-ordination is needed even though the global economy is in the midst of an unprecedented phase of high growth, low inflation and greater economic and financial convergence. <sup>[9]</sup>

The main points made by Mohamed El-Erian are:

- Greater international co-ordination is needed in spite of:
  1. Unprecedented high growth
  2. Low inflation
  3. Greater economic and financial convergence

### Comments:

So, the global economy is said to be in an unprecedented high growth phase. This sounds like a good occurrence – but is it? What is meant by the global economy is growing? How is it determined or measured to be growing?

The gross domestic product of the world is the measure that is used. However, we have just seen that gross domestic product is merely the measure of spending – of consumption. Where is the money coming from to finance the increased consumption?

It is not coming from a commensurate rise of income, nor of savings. The only other choice is credit and debt. Consumption is being financed with excess credit and debt growth on a global level. The global economy may be growing, but at what cost? At the cost of ever increasing debt levels, of life prostituted to debt servitude, feudalism the 21<sup>st</sup> century style.

And the saddest part is it is not only our lives, but the lives of our children and their children, who will be working to service the debts we are racking up. Think about it – long and hard. It is not what it is made out to be. It is an illusion – no different then the illusion in the Wizard of Oz – literally and figuratively. The book was actually about this very same topic of gold and silver versus the illusion of the emperor who stands naked behind the curtain – the illusion of paper debt-money as being real.

### **Low Inflation**

I have no idea what Mr. El-Erian is referring to with his statement about low inflation. As I said in part one, not only are we not on the same page regarding this topic, I don't think we are even in the same book.

As was shown in the first paper, there are many types of inflation: price inflation, wage inflation, asset inflation, and monetary inflation. None of the other flations can occur unless there is first monetary inflation. Monetary inflation is the root cause. The other inflations are a result or effect of the root cause.

The United States has gone on a huge consumption orgy for the last several decades, fueled by ever increasing credit and debt levels that have extracted liquidity from out of the real estate market. The housing market has not been sucked dry by the [Vampires of the New World Order](#) – there is nothing more to feast on: a new host is now needed.

This unwanted credit and debt expansion has created record setting levels of dollars that are flooding the entire world in an ocean of liquidity, causing ASSET INFLATION BUBBLES around the globe. A huge amount of the created dollars gets recirculated right back to the United States as payment for buying our Treasury Debt. Japan and China alone count for almost half of our Treasury debt market.

## Greater Economic & Financial Convergence

I'm at a loss of words on this one. The only thing I see converging are excessive credit and debt levels with a global out-of-control debt financed boom – all headed for the inevitable bust that follows such booms. The massive excess monetary inflation and debasement of all paper fiat currencies is an accident looking for a time and place to happen. It is not a question of if – but when.

### Eighth Paragraph

We should view these themes not as competing but as part of a fundamental change in the global economy. Consider five issues that face the public and private sectors. <sup>[10]</sup>

The main points made are:

- We should view these themes not as competing
- But as part of a fundamental change in the global economy
- By considering five issues that face the public and private sectors

### Comments:

The themes are said not to be competing, but just part of a structural change in the global economic order. To be precise, the themes are:

1. The continued robustness of the global economy, as defined by sustained high growth and low inflation.
2. The steady rise in economic and financial risks. <sup>[11]</sup>

We have seen that a robust global economy as defined by high growth and low inflation is a chimerical illusion at best, and deceptive enslavement at worst. An expanding gross domestic product simply refers to increased consumption had by excess spending, and the requisite borrowing needed to finance the buying frenzy with.

The only individuals creating wealth, are those who collect the perpetual interest rate streams on the debt service, and in truth, even they are not creating wealth. They are merely transferring wealth from others to themselves. It is with good reason that it has been written: never a lender nor a borrower be. It is a sinister game being played out – of that there is no doubt.

I agree that there has been a steady rise in economic and financial risks. How could such not be the case in paper fiat land: where money is debt, and debt money? With derivatives equivalent to seven years of the entire gross product of all goods and service in the entire world, we are lucky that the system has not yet exploded or imploded.

See [Scylla & Charybdis: The Scourge of Mankind](#) for details on deflation vs. hyperinflation. The way out of this quagmire can be had, but it will not be easy. The answer is Honest Money – the hard money system of our Constitution: gold and silver coin.

This ends the second paper on [Complex Finance and the Brave New World Economy](#). There is one last article to come.



"The kings of the earth, who committed sexual immorality and lived wantonly with her, will weep and wail over her, when they look at the smoke of her burning, standing far away for the fear of her torment, saying, 'Woe, woe, the great city, Babylon, the strong city! For your judgment has come in one hour.' " [12]

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[1] Revelations 17:18

[2] Revelations 18:3

[3] Complex Finance and the Brave New World Economy

[4] Jean-Claude Trichet as reported by Gillian Tett in Davos

[5] Malcolm Knight, Manager of the BIS

[6] Stanley Fisher, Governor of Israel's Central Bank

[7] Paul Volcker, Former Chairman of the Federal Reserve

[8] Robert Rubin, Former Secretary of the Treasury

[9] Complex Finance and the Brave New World Economy

[10] Same

[11] Same

[12] Revelations: 18:9 and 18:10