

Honest Money Gold & Silver Report

The Brave New World Economy

A Rejoinder to Mohamed El-Erian



The merchants of the earth weep and mourn over her, for no one buys her merchandise any more; merchandise of gold, silver, precious stones, pearls, fine linen, purple, silk, scarlet, all expensive wood, every vessel of ivory, every vessel made of most precious wood, and of brass, and iron, and marble; and cinnamon, incense perfume, frankincense, wine, olive oil, fine flour, wheat, sheep, horses, chariots, bodies, and people's souls. ^[1]

Introduction

This is the third and final 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 two papers 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 my 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.

Ninth Paragraph

First, the information content of market indicators that serve as traditional inputs for policymaking and market positioning has significantly distorted. This is true for staples such as the shape of yield curves and market measures of volatility and risk spreads. ^[2]

The main points made by Mohamed El-Erian are:

- The information content of market indicators that serve as traditional inputs for policymaking and market positioning has significantly distorted.

- This is true for staples such as the shape of yield curves and market measures of volatility and risk spreads.

Comments

Traditional market indicators are said to have distorted, which is true. The yield curve in the United States is given as one example, and a very good one at that. Secondly, the capability of the market to properly measure risk spreads is offered as another deviant result of distorted inputs.

I trust Mr. El-Erian does not include deviant inverted yield curves, and distorted and unreliable measures of risk spreads, as part of the new structural changes in the global financial arena that should be accepted and embraced; and then recalibrated to attempt to provide a new way forward.

To provide more than a temporary fix to any given problem, one needs to address the cause of the problem – not just the symptoms. Take a person that smokes a pack of cigarettes a day. They develop emphysema accompanied by coughing and shortness of breath.

They take cough medicine and use a breathalyzer, which gives some short term relief, but that is the extent of any attempt at finding a remedy. Unless they stop smoking, which is the cause of the disease, they are not going to get better. Period.

The inverted yield curve in the United States is the direct and intentional policy adopted by the Federal Reserve. The record shows this very clearly. Short term rates have been strategically and purposely raised by the Fed to be higher than long term interest rates. The spread between the two year Treasury Note and the ten year Treasury note has been steadily widening.

Israel's central bank governor, Stanley Fisher, had the following to say in Davos:

“on the issue of the risk aspect of the explosion of financial instruments and derivatives, policymakers are not entirely happy.” ^[3]

The president of JP Morgan International, Andrew Crockett, speaking on derivatives said:

“these new instruments ought to make markets more complete. But there is a lack of transparency . . . we don't know how much leverage there is in hedge funds, for example.” ^[4]

Once again, the above statements offer evidence that the financial markets, especially the derivative markets, have imbalances and malinvestments that are adding to systemic risk - rather than reducing it.

Are these more of the structural changes in the world's financial system that should be accepted as part of the status quo, with the market's response being to simply recalibrate in an attempt to find a way forward?

Or are these structural changes undermining and weakening the financial system, thereby calling out for change, as opposed to acceptance? Why the proliferation of such vehicles? Cui Bono? Follow the money is the simple answer.

Tenth Paragraph

Second, several countries must improve their policy tools to navigate their new circumstances. In emerging economies the traditional focus on liability management needs to be complemented by more sophisticated asset management capabilities. ^[5]

The main points made by Mohamed El-Erian are:

- Several countries must improve their policy tools to navigate their new circumstances
- In emerging economies the traditional focus on liability management needs to be complemented by more sophisticated asset management capabilities

I would be curious to know just who the several countries are that should improve their policy to navigate their new circumstances. The next sentence, which follows, concerning emerging economies, suggests that Mr. El-Erian is referring to these economies as needing the new policy tools.

In other words, because the United States has engaged in an orgy of issuing excess money and credit, which in turn has fueled asset inflation across the globe, the recipients of this excess liquidity should adjust their economic policies accordingly.

Balderdash – it is the United State's profligate credit and debt issuance that should be adjusted, as IT IS THE CAUSE OF THE GLOBAL BOOM AND RESULTING ASSET BUBBLES. And after every boom a bust follows: as night follows day.

Emerging markets are being advised to compliment traditional liability management by the use of more sophisticated asset management capabilities, which once again is suggesting resorting to the derivative and structured finance markets that are at the core of the problem; and as such, cannot possibly be the remedy for the disease.

It is no different then telling a junkie he will feel better by taking a higher purity dose of heroin. Such may provide a short term fix, but in the long run it will kill the addict.

Eleventh Paragraph

Third, while financial innovations have enhanced risk management tools, a rise in risk efficiency does not entail a decline in risk. Rather, emboldened by new opportunities to tranche and securitise risk, many investors have moved up the risk curve. This shift is placing pressure on the infrastructure that supports settlement and operational risk management. ^[6]

The main points made by Mohamed El-Erian are:

- Financial innovations have enhanced risk management tools
- A rise in risk efficiency does not entail a decline in risk
- Emboldened by new opportunities to tranche and securitise risk, many investors have moved up the risk curve
- This shift is placing pressure on the infrastructure that supports settlement and operational risk management

Comments

I couldn't agree more with the fact that the new age financial innovations (structured finance and derivatives) have not produced a decline in risk, and that many investors have been emboldened to attempt to securitise such risk, by moving up the risk curve.

Yet, these are the self-same tools that are providing the excess liquidity to fuel the present global boom, which is placing pressure on the financial infrastructure, heading it towards the inevitable bust that follows every boom.

Notwithstanding those who contend otherwise, the basic laws of economics have not been rescinded, and the more that man tries to control them by market intervention, the more the imbalances and problems grow, until the system destroys itself, or man chooses to implement Honest Money to remove the moral hazard and fraud of a monetary system that allows paper fiat debt-money to circulate as the currency.

Rather than accepting malinvestments and excessive credit issuance as part of the new world order, such deviant malignancies should instead be viewed as non-acceptable products of a paper fiat monetary system that is completely run amuck. It is time for Honest Money, as our Constitution mandates: Gold and Silver Coin, and no bills of credit.

[Article I, Section 10, Clause 1](#) states that: "No State shall...coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debt." ^[7]

A constitutional amendment has never made to alter the above, therefore it still stands, as part of the Supreme Law of the Land. Furthermore, there was a reason the Founding Fathers were against paper fiat debt-money: they had witnessed the destruction it causes. A simple reading of the Congressional record from that time clearly illustrates this simple, but powerful fact.

Paragraph Twelve

Fourth, regulatory efforts aimed at maintaining financial stability also need to be more sensitive to changes in the technical components of liquidity. ^[8]

The main points are:

- [Regulatory efforts aimed at maintaining financial stability also need to be more sensitive to changes in the technical components of liquidity](#)

Comments

Trying to regulate a paper fiat monetary system predicated on the use of debt-money circulating as the currency is an impossible task. Such a system inherently has inflation built into its genetic structure. More and more money (credit/debt) are required just to service the interest charges on the existing debt, let alone to pay it off (which is impossible).

The regulation that should be used is the regulation the United States Constitution calls for:

[Article I, Section 8, Clause 5](#) of the Constitution states: "The Congress shall have Power...To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures." ^[9]

The technical components of liquidity are the exact problems that need to be abolished, not embraced and recalibrated. It is a known fact that when the frame on a car is bent badly in a collision, any repairs done to "straighten" it out will never return the frame to its original integrity and soundness.

EVEN A RETURN TO THE GOLD STANDARD WILL NOT WORK. See: [Can the U.S. Return to a Gold Standard?](#) (click link for details).

Paragraph Thirteen

Finally, as recognition grows that international financial institutions are becoming less relevant, some difficult decisions face their shareholders if they wish to keep them effective and credible. At the minimum, they must agree on better representation and governance, a more sustainable income model and a sharper focus. ^[10]

The main points made by Mr. El-Erian are:

- Recognition grows that international financial institutions are becoming less relevant.
- Difficult decisions face their shareholders if they wish to keep them effective and credible.
- At the minimum, they must agree on better representation and governance.
- And a more sustainable income model and a sharper focus.

Comments

The U.S. dollar is the reserve currency of the world. It is the excess sea of liquidity that the U.S. has flooded the world with that lies at the heart of the many imbalances and pressures that presently place horrific strain on the global financial system.

Any corrective action that has even a modicum of a chance to produce positive results, must first start with the U.S. dollar, and the monetary system of the United States: the reserve currency of the world. To think otherwise is utter folly.

A more sustainable income model is not what is needed: what is needed is a sound and honest monetary system not based on debt – that is where the focus should be. To allow the public debt to circulate as the currency is not only against the Constitution, it is visiting a plague upon the world, it is prostituting the world to a life of debt slavery to pay the man.

Paragraph Fourteen

These five issues are an illustration of the complexities that face us in a world where seemingly competing themes are in fact consistent components of a bigger phenomenon. They speak to how today's vibrant economies and markets are looking to exploit opportunities afforded by significant structural changes. They also show how risks are evolving with these opportunities. It is time for policy debates to reflect these realities. ^[11]

The main points made by Mr. El-Erian are:

- The above five issues are an illustration of the complexities that face us in a world where seemingly competing themes are in fact consistent components of a bigger phenomenon.
- Vibrant economies and markets are looking to exploit opportunities afforded by significant structural changes.
- Risks are evolving with these opportunities.
- It is time for policy debates to reflect these realities.

Comments

Mr. El-Erian reiterates the point that the five issues he presents illustrate the complexities that we face in the financial world, yet he also stresses that these five issues are not competing themes, and are in fact consistent components of a bigger phenomenon.

He does not explain, however, exactly what this bigger phenomenon is, although it appears that he is referring to the global economic boom of vibrant economies and markets, and the various structural changes that have manifested themselves within the world's financial system, either as a result thereof, or as a cause thereto.

Thus, he posits that the world's vibrant economies and markets are looking to exploit opportunities afforded by these significant structural changes. Earlier Mr. El-Erian stated that the continued robustness of the global economy, as defined by sustained high growth and low inflation, and the steady rise in economic and financial risks, were the two basic themes in the Brave New World Economic Order that were not competing with one another, but were part of a fundamental change in the global economy.

What are some of the structural and fundamental changes to the global economy that the markets are looking to exploit? Let's go back and list them as they were presented.

- Acceleration in the realignment of the global economy.
- Productivity shock from the absorption of massive numbers of workers into the global labor force from emerging economies.
- Increase in commodity prices that has transferred wealth to raw material exporters in the emerging world.
- A new set of countries now exercises a greater (and different) influence on four key global variables:
 1. Growth
 2. Trade
 3. Price Formation
 4. Capital Flow
- The systemic impact of this global realignment would have been less dramatic if:
- The bout of financial innovation triggered by the proliferation of derivative based instruments had not occurred.
- This has reduced the barriers to entry to almost all markets and encouraged the migration of capital towards more illiquid and leveraged asset classes.

Furthermore, the above economic and technical changes are producing alterations in the global economy, which are additional changes to the structure of the global system.

- 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.
- The information content of market indicators that serve as traditional inputs for policymaking and market positioning has significantly distorted.
- This is true for staples such as the shape of yield curves and market measures of volatility and risk spreads.
- Financial innovations have enhanced risk management tools.

- Emboldened by new opportunities to tranche and securitise risk, many investors have moved up the risk curve.
- This shift is placing pressure on the infrastructure that supports settlement and operational risk management.

As the song says, “there’s a whole lot of shakin going on.” That is a serious list of monumental changes taking place within the global economic system. To think that none of these changes are competing with one another is nothing more than denial; and accepting them as structural changes that are consistent components of a vibrant and healthy world economy strains all creditable thought and analysis.

We have questioned and commented on every one of these themes, issues, and changes, and will not bore the reader with further reiteration, which by now should not be needed to add to the understanding of what is transpiring within the global economy: an illusionary crack up boom, fed by the over issuance of excessive credit and debt that is not producing wealth for the average worker, but is transferring wealth from the majority to the elite minority that controls such credit and debt issuance. As evidence we offer the following.

Evidence

Sustainable growth rates that are increasing due to both productivity and savings are of prime importance in determining rising levels of income and living standards. If debt fulfills a larger part of the increasing growth rate then income and savings, then living standards are not increasing – they are decreasing.

The nation is presently increasing debt levels just to maintain and expand consumption, when it should be producing real goods and accumulating excess production, as real savings - by foregoing consumption. The decision not to consume all goods produced is the key to accumulating both savings and eventually wealth. It is also the foundation of sound capital formation, which in turn produces more wealth and raises the standard of living.

Household debt ratios increased **90% faster** than growth of the economy since the late 1960s. Any growth in the economy was caused by rising debt levels, while real family incomes either stopped rising, or at best rose much less than existing debt levels. This shows that real equity and savings have not been the driving force of the so-called economic growth - it has been **debt driven**.

In 2005, \$3.54 trillion of new debt was added in comparison to 2004, yet national income increased by only \$448 billion. Consequently, it took \$8 of newly added debt to produce each new dollar of national income. This is a huge ratio, which explains the soaring debt trend levels alluded to above.

Total global debt issuance increased 14% in 2006 - to a record US \$7 TRILLION dollars. The U.S. had the infamous distinction of being at the head of the class, with total debt issuance in 2006 increasing by 10% to \$US 4 TRILLION dollars.

The US economy (\$12 trillion GDP) is approximately 20% of the global gross domestic product (\$55 trillion), which means the U.S. issued debt at almost three times its relative global economic size.

Consequently, newly issued debt has less of an effect in creating growth. For example: in 1980 it took \$1 of new debt to create \$1 of GDP; in 2000 it took \$4; and today it takes \$7.

This is NOT a good trend. This is NOT how wealth is accumulated. This is how the standard of living falls to unheard of levels. This is the road to perdition – not to prosperity.

The America Dream is no longer possible for the average or even above average family. Only the elite rich can obtain financial success that was once available to all Americans, and

increasingly they are found to be working in the financial sector of the economy – pushing paper debt out as America's new export of choice.

Debt vs. Savings

Today America is the **largest debtor nation in the world**, with increasing record deficits occurring each year. Beginning in the 1970's, the nation's trade balance kept registering a negative ratio: we consumed more than we produced.

Both productivity and savings have gone steadily downhill, causing real disposable incomes to grow at a slower and slower pace, until they stopped increasing at all. Between 1999 and 2005, real household incomes fell 94%.

America now has the lowest savings rate since 1929: minus -1.6%. Yet, debt levels continue to climb. This is not how wealth is accumulated, at least not for the average family; the elite bankers who issue all this debt are doing just fine thank you. Can you spare another cup of porridge sir?

TRADE DEFICITS INDICATE DECLINING PRODUCTIVITY

If the U.S. had increasing productivity, it would be competitive with other nations of the world, and would therefore, produce trade surpluses, as opposed to the record trade deficits it keeps racking up month after month, year after year.

The U.S. trade deficit set a fifth consecutive annual record in 2006. The Commerce Department reported imports rose to a record \$763.6 billion last year, a 6.5% increase from the previous record of \$716.7 billion set in 2005. The 6.5% increase for 2006 followed on the heels of a 17% rise in 2005, and 23% in 2004. This is another ominous trend that one does NOT want to see.

If we are truly more productive each year as a nation, then the economy should not require more debt each year to help produce the gross domestic product. In 2006, our economy recorded the lowest rate of labour productivity growth in more than a decade. The European Union, Japan, China and India all had more growth in output per hour than did the U.S.

Export of Jobs Overseas

Three million manufacturing jobs have been lost since President Bush took office. More and more jobs are moving overseas to take advantage of cheap labor and lax environmental regulations, as Mr. El-Erian noted.

Productivity growth is just another fantasy in paper fiat land. The measure of productive labor growth, as measured in output per hour, does not even take into consideration the rising debt levels, expanding trade, current account and budget deficits, negative savings rate, or stagnant real incomes.

Productivity rates used to be between 3-4%. Then productivity rates began to decline, eventually falling to the 2% level. In 2006, productivity fell to 1.4%, the lowest rate of the last decade.

The same phenomenon can be found in the number of manufacturing workers. Back in the 1960's the percentage of all U.S. workers was 26%. It steadily decreased to 10% in 2004, a 60% drop in the manufacturing ratio. Since the 1950's the manufacturing base, as a percent of GDP, has fallen from 30% to 12%, which represent a 58% loss.

It is impossible for the United States to be able to produce and then export enough goods to balance our negative trade deficit, if our manufacturing base is eroding. Once again, this is a pernicious trend that leads to debt servitude – not to a life of prosperity.

Toward What Goal

Is this what you want to leave your children and their children to - a life of debt servitude as indentured servants? Or would you prefer to see your children work hard and save the fruits of their labor, as increased wealth and an improving standard of living?

What is needed are improving labor and management skills coupled with cutting edge technology and more efficient equipment that increases productivity by the sound use of SAVINGS as capital formation, resulting in an expansion of the manufacturing base.

Real productivity increases would then result in sustainable growth of national incomes without increasing debt. Personal savings would begin to accumulate, which can be used to further increase capital formation, and to increase the manufacturing base even more.

Furthermore, the surgical removal of today's flawed monetary and financial policies, coupled with the implementation of the several corrective measurements sited above, would help in lessening the loss of purchasing power the U.S. dollar currently experiences.

An expanding manufacturing base would help in strengthening and stabilizing the US Dollar, resulting in a trade surplus with the rest of the world, as opposed to today's trade deficit – if Honest Money of gold and silver coin were the monetary foundation upon which the financial and economic system is built.

However, the only way to return our monetary system to a sound and viable system is to return to the hard money system mandated in our Constitution: gold and silver coin. Only Honest Money has the power required to rectify the national disgrace, which goes by the name of the United States monetary system, as administered by the Federal Reserve.

To reiterate: we find ourselves on the monetary road to perdition – not to the realization of the American dream. We must first admit and then face the following issues:

- Rising debt levels
- Purchasing Power of the dollar steadily eroding
- Real disposable Income levels falling
- Savings are non-existent
- Trade Deficit steadily rising
- Current Account Deficit steadily rising
- Budget Deficit steadily rising
- US Net International Investment Position is –3 Trillion Dollars
- US Dollar has been displaced by the Euro as the world currency of choice
- The manufacturing base keeps shrinking
- Japan, Germany, and China have surpassed us in productivity output per capita

The GSEs: Where Do We Stand?

William Poole
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St. Louis, Missouri

Jan. 17, 2007

"In what follows, I'll confine most of my comments to Fannie Mae and Freddie Mac, where the largest issues arise. My purpose is to make the case once again that failure to reform these firms leaves in place a potential source of financial crisis. Although there is pending legislation in Congress, a major restructuring of these firms and genuine reform appear to be as distant as ever."

"Since the GSE accounting scandals emerged in mid-2003, one thing has remained rock-solid: The GSEs have continued to borrow at yields only slightly higher than those of the U.S. government, and noticeably lower than those available to any other AAA-rated private company or entity. In other words, despite the vast recent accumulation of knowledge about the significant risks run by the GSEs, as well as their inability (or unwillingness) to manage these risks, investors in GSE debt securities appear unmoved. Upon reflection, the lack of market discipline evident during this crisis period is striking—like a dog that did not bark. This fact indicates to me that there still is a significant problem with the GSEs that needs to be fixed."

"I began this speech noting that the Federal Reserve has a responsibility to maintain financial stability. That responsibility includes increasing awareness of threats to stability and formation of recommendations for structural reform. I do not believe that a GSE crisis is imminent. However, for those who believe that a GSE crisis is unthinkable in the future, I suggest a course in economic history." ^[12]

Panel on Government Sponsored Enterprises

William Poole, President, Federal Reserve Bank of St. Louis
The 40th Annual Conference on Bank Structure & Competition
The Fairmont Hotel
Chicago, Illinois

May 6, 2004

Dangers of Borrowing Short and Lending Long

[Emergency Powers of the Fed](#)

"It has long been a canon of sound finance that a firm should not borrow short to finance long-term assets. There are two reasons for this principle. First, a financial firm exposes itself to interest-rate risk when the duration of assets and liabilities does not match. Second, a firm must continuously roll over short-term liabilities that are used to finance long-term assets."

"Investors in short-term obligations apparently believe that they are completely protected from credit risk because they will have enough warning to permit them to exit these obligations by letting them mature in a few months. The problem is that should a crisis occur, it would take hold so quickly that GSE obligations will in a matter of hours, or days, become illiquid. While any one holder of GSE debt can exit, not all holders together can exit at once.

The economics of this market are similar to those of banking markets. A scramble to convert all bank deposits into cash cannot succeed in the aggregate because not enough cash exists to effect the conversion. Similarly, a scramble to convert GSE obligations into cash cannot succeed in the aggregate because the underlying mortgage assets cannot be quickly converted to cash. Mortgagors are under no obligation to prepay long-term mortgages."

"The Federal Reserve has ample power to deal with a liquidity problem, by making collateralized loans as authorized by the Federal Reserve Act. The Fed does not have power to deal with a solvency problem. Should a solvency problem arise with any of

the GSEs, the solution will have to be found elsewhere than through the Federal Reserve.” [13]

From the above it can be seen that even main stream economic analysis admits of the distortions and problems that have risen within the monetary and financial systems of our economy.

To consider these malignant growths as consistent structural changes to the monetary and financial systems of the world - is to accept the unacceptable: a life of debt servitude no different than an indentured servant. It goes against the very foundation of the Constitution of the United States: freedom, liberty, and justice for all.

Do not be fooled by false profits that offer explanations that perpetuate the same system that the Babylonian Brotherhood has so espoused for thousands of years. Make no mistake, as it is being perpetrated without mistake – with full knowledge and purpose of design.

Form follows function. Follow the money. Knowledge is power. Empower yourself – and vote accordingly. Vote for Honest Money. Vote for your unalienable rights the Constitution defines as the Supreme Law of the Land. You are sovereign – do not accept less.



The fruits which your soul lusted after have been lost to you,
and all things that were dainty and sumptuous have perished from you,
and you will find them no more at all.

The merchants of these things, who were made rich by her,
will stand far away for the fear of her torment, weeping and mourning;
saying, 'Woe, woe, the great city, she who was dressed in fine linen, purple,
and scarlet, and decked with gold and precious stones and pearls!

For in an hour such great riches are made desolate.'
Every shipmaster, and everyone who sails anywhere, and mariners,
and as many as gain their living by sea, stood far away, and cried out
as they looked at the smoke of her burning, saying, 'What is like the great city?'

They cast dust on their heads, and cried, weeping and mourning, saying,
'Woe, woe, the great city, in which all who had their ships in the sea were made rich by
reason of her great wealth!' For in one hour is she made desolate. [14]

For When the Perfect Comes - the Imperfect Shall Cease to Be

[1] Revelations

[2] Complex Finance and the Brave New World Economy

[3] Stanley Fisher – Governor of the Israeli Central Bank

[4] Andrew Crockett – President of JP Morgan International

[5] Complex Finance and the Brave New World Economy

[6] Same

[7] Constitution Article I, Section 10, Clause 1

[8] Complex Finance and the Brave New World Economy

[9] Article I, Section 8, Clause 5

[10] Complex Finance and the Brave New World Economy

[11] Same

[12] William Poole, President, Federal Reserve Bank of St. Louis
[13] William Poole, President, Federal Reserve Bank of St. Louis
[14] Revelations