



1st June 2010

The return of real money

“The UK Debt Management Office (DMO) has been voted the most impressive sovereign funding team and DMO chief Robert Stheeman as most impressive sovereign funding official, said EuroWeek. The top award comes as the DMO sold a record £227.6 billion worth of Gilts in FY 2009/10. Hopefully, Stheeman should have better luck than the recipient of last year’s award for most impressive sovereign funding official, who was Spyros Papanicolaou, who is now the ex-chief of the Greek Public Debt Management Agency.”

- Hat-tip to Jonathan Escott.

Swiss fund manager Felix Zulauf gives a pretty extraordinary interview on [King World News](#). Not extraordinary in the sense of wildly illogical, but extraordinary in the sense of its candour and absolutely chilling in its implications. In short, the industrialised world is drowning in debt that it ultimately cannot service. Zulauf suggests that when – not if – the next banking crisis hits, governments will be unable to step in and support them as they did in 2008, because their own finances are fatally impaired and their capacity to borrow cannot be extended indefinitely. “We have been living in a fiction for the last 20 years or so.. we thought we could borrow ourselves into sustained prosperity.” That which cannot continue forever will not. Zulauf foresees years of deflationary crisis that will culminate in the eventual replacement of the current fiat monetary system. This thesis is, of course, hugely positive for gold, the one currency that doesn’t come with counterparty or credit risk or concerns about oversupply, but hugely negative for financial assets. And it also highlights just what a disaster it has been for the UK in David Laws to lose by all accounts one of the best-placed administrators to tackle the national deficit. As one trader remarked last week, before Laws’ resignation, “David Laws is not a namby-pamby politician – he is a real person”. Having effectively outed Laws and his technical breach of Commons guidelines, The Daily Telegraph is now pursuing his replacement at the Treasury for allegedly avoiding capital gains tax on his second home. This is not a democracy, this is the Salem witch trials – what Stanley Baldwin and Rudyard Kipling referred to regrettably as power without responsibility. At a time of grave national crisis, we deserve better from our press.

Who wins the war between States and Corporations ? Ian Bremmer asks the question in his new book, “The End of the Free Market”. It feels like we are in the process of finding out. Across the industrialised world, the State is in the ascendant. President Obama in a shameful attempt to curry favour with a disillusioned electorate has his press secretary pledging to keep his administration’s boot on BP’s throat; in Europe, Chancellor Merkel promises to “win the battle” on behalf of politicians with the free market as the enemy; in Australia, the government has suddenly unveiled a Resource Super Profits Tax on the mining sector which may raise \$11 billion in its first two years.

In the UK, the population nervously awaits an emergency budget which will shed some light on just how much private wealth the government intends to seize to try and balance its books. It is as if governments are unaware that we live in a globalised world where people can and ultimately will relocate if squeezed too hard by near-bankrupt state authorities. On the topic of BP alone, Lew Rockwell recently asked on the consistently excellent [Mises](#) website “Feel Sorry for BP ? ..It should be obvious that BP is by far the leading victim, but I’ve yet to see a single expression of sadness for the company and its losses.. It is not as if BP profits by oil leaks, or that anyone revelled in the chance to dump its precious oil all over the ocean. BP gains nothing from this..” Rockwell concludes that other than environmentalists, the only party likely to be happy about the disaster is government, “which treats every capitalist producer as a bird to be plucked.” And the US government has also, with breathtaking irony, pledged to overhaul the regulators of the industry. Physician, heal thyself.

[The Daily Bell](#), like Felix Zulauf, draws attention to the deflationary decline in the US money supply:

“The real reason that banks STILL aren’t lending much may also have to do with the depth and breadth of the downturn. We’ve written in the past this is no ordinary downturn but a fiat-money blowoff. Western paper currencies, in fact, have all failed at once, including king dollar. They have failed because incessant credit stimulation has so distorted Western economies that even after two years, these economies have not yet returned to a point where banks and other investors can tell the difference between a legitimate opportunity and one that has been kept alive by various forms of governmental chicanery. This is why “stimulus” and “bailouts” are ultimately so counter-productive. They actually retard economic recovery.

“Economic ignorance also plays a part in the current crisis. After more than 100 years of concentrated power-elite propaganda, people are rightly confused about money, what it is, and how it works. In a normal-money economy (one with silver and gold) money would gain in value (deflation) gradually over time (rather than lose value to “inflation”) because technology would gradually make most goods and services more efficient. During an economic downturn, money might even appreciate faster – cushioning a recession by making savings that much more valuable.

“But in a pure fiat-money environment with mercantilist central banks and their governments spewing money like the BP oil leak in the Gulf, the money economy becomes increasingly distorted along with the real one. The issuance of debt-based pure fiat currency is an invitation over the long-term to disaster. Initially, the phony dollars fool businesspeople into thinking they are richer than they are. Eventually, the economy becomes so distended and distorted that price signals break down, stock markets crash and a recession – or depression – takes hold.

“At this point, money is seen to shrink – to evaporate. Initially, money is seen to disappear because it is locked into non-performing assets that are suddenly seen as irretrievable. And then, banks (the only large entities allowed to lend in a traditional sense) won’t lend because it is not possible to make a distinction between what is valuable from what is valueless.”

What is valuable at a time of such combined debt and currency crisis is what is comparatively rare, the likes of precious metals, which can be dug up out of the earth, but only with costly effort and resources. What is not valuable is the deteriorating fiat currency of increasingly discredited administrations. As political risk rises throughout the world, investors would be well served by re-examining what real money is, and just as importantly, what it is not.

Tim Price
Director of Investment
PFP Wealth Management
1st June 2010.

Email: tim.price@pfpg.co.uk

Weblog: <http://thepriceofeverything.typepad.com>

Bloomberg homepage: PFPG <GO>

Important Note:

PFP has made this document available for your general information. You are encouraged to seek advice before acting on the information, either from your usual adviser or ourselves. We have taken all reasonable steps to ensure the content is correct at the time of publication, but may have condensed the source material. Any views expressed or interpretations given are those of the author. Please note that PFP is not responsible for the contents or reliability of any websites or blogs and linking to them should not be considered as an endorsement of any kind. We have no control over the availability of linked pages. © PFP Group - no part of this document may be reproduced without the express permission of PFP. PFP Wealth Management is authorised and regulated by the Financial Services Authority, registered number 473710. Ref 1045/10/SB 010610.