

Central Bankers' Bogus Wand Will Have No Effect

written by Egon von Greyerz | February 24, 2016

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Central Bank heads believe they are magicians who can wave their magic wand to create whatever economic conditions they desire. But the problem is that they are consistently wrong in their assessment of the economy so they don't know what to do with the wand. Also, the wand is not magic but just bogus. And this is the dilemma of all central banks. They are given unlimited powers to manipulate monetary policy and to print money.

But when you give infinite powers to someone who can neither assess the situation properly nor understands the consequences of his actions, it is like giving weapons of mass destruction to a bunch of kids. But it is actually worse than that because the bankers are using the weapons to create wealth for their banker friends. Thus, central banks have created mega wealth for an infinitely small minority and unlimited debt and misery for the rest of the world. What central banks are doing is to create booms and busts of a magnitude that totally destroys the economy. And this is exactly what will happen in the next few years again.

The world economy would function considerably better without central banks. Instead of the massive booms and bust that we currently have, there would just be natural self-correcting economic cycles of much smaller amplitude. Because the turn of the cycle that is now beginning will change the world for a very long time. One hundred years of mismanagement will lead to economic and human misery that could last decades or even centuries like the end of the Roman Empire.

There are no honest politicians

Back in December after the Fed rate increase, we discussed that the Fed again made an incorrect decision which soon would have to be reversed. Well, this week in her statement to Congress, Yellen started to backtrack. But like all politicians she neither sees nor would admit to that most of the global economic problems stems from US monetary policy. It is because the US has lived above its means for over half a century and flooded the world with worthless printed dollars that we are now in this mess. But since she is a politician, she would ever admit to that. Instead this week she blamed global market turbulence and higher risks from China as the reasons for conditions being less supportive of US growth. It is amazing how politicians can never be honest and see the log in their own eye rather than the splinter in their neighbour's eye.

It reminds me of Gordon Brown, the former labour prime minister who when he was chancellor of the exchequer told parliament that he had abolished boom and bust. But when the 2006-9 crisis started, he blamed international conditions and not his own mismanagement of the U.K. economy. This is the immorality of politicians; they take credit for all good things but blame others for all the disasters they create.

US to join the negative rate club

So Yellen has made another mistake which she half admitted to. As I said back in December, it will not be a question of no more rate increases but of rate reductions and probably even negative rates. She confirmed that the Fed is studying negative rates. She said "We would want to be prepared in the event that we needed to add accommodation". This Fed speak is just unreal. Why can't they ever use language so that ordinary people understand. Well we know why. They create fancy terms like quantitative easing and accommodation to make people believe that the Fed is doing something very complex and clever. Why not use the proper words like money printing and interest manipulation? But then the world would know it is just trickery so that is why they must hide behind incomprehensible Fed speak. Anyway, Yellen knows that negative rates are likely to come to the US and join the 13 countries who have it already.

The competition who has the lowest rates is hotting up. Switzerland is still leading with -0.75%. But Sweden is now catching up and just went to -0.5%. (I promise it is just a coincidence that I am both Swedish and Swiss!) Sweden's economy is in relatively good shape currently so a rate reduction is not really justified. But the Riksbank's official reason was that inflation is too low. What they don't realise is that low or negative rates don't stimulate the economy. It discourages savings and therefore also discourages investment. But the real reason to lower rates is not low inflation but to win the currency race to the bottom. This is what Sweden and Switzerland are competing for together with at least another 11 countries with negative rates.

Investors have a misplaced faith in bubble markets

Financial markets have for years ignored economic reality and just rejoiced over money printing and credit creation. We have said for quite some time that these false conditions would end in tears and this is what is finally happening since the start of 2016. This is of course just the very beginning. There is no panic yet in markets but that will soon come. In the last week I have met with a number of ultra-high net worth individuals. They are worried but not enough to change their investment strategy which mainly consists of private equity, hedge funds and property. Hedge funds in general have had a bad 2015. Private equity investments are valued at fantasy prices. Very few investors realise that they might only get half the valuation in current market conditions. And it is fascinating how property investors believe that they are holding a wealth preservation asset. Little do they realise that bricks and mortar have zero value when buildings are empty with no income stream.

Unprecedented wealth destruction

We will see the most massive wealth destruction in history in coming years. Most investors will hold on until the bottom when maybe up to \$200 trillion dollars' worth of investments have evaporated. What is interesting is that very few of the wealthy investors I meet hold gold or understand gold. But that is of course natural since less than 1/2% of world financial assets are in gold. Very few realise that the Dow and other stock markets have lost 71% against gold since 1999. But more importantly, in 2016 the Dow has already lost 22% against gold. Before this asset destruction is over, the Dow will lose at least another 90% against gold. If investors realised that just putting say 20% of their market investment into physical gold, they would both insure their assets and preserve wealth.

2007-9 was just a warning shot

We are now seeing bad news everywhere. Take AP Møller Maersk for example. They are the world's biggest container shipping company and had a Q4 loss of \$2.5 billion. Their CEO stated that conditions are now worse than in 2008. I repeat what I have said many times; the 2007-9 crisis was a light rehearsal. What happened then will be dwarfed by the economic collapse in coming years. In 2006 interest rates were a lot higher worldwide. In the US for example short term rates were 5%. Since then there have been 637 rate cuts which have led to 500 million people living in countries with zero or negative rates. Also since 2007 governments have spent over \$12 trillion buying assets, a major part of which is worthless.

Will financial system survive

And finally investors are waking up to the fact that most banks are unlikely to survive the coming crisis in tact or maybe not at all. Bank stocks around the globe are down 20-40% this year. The cost of credit default swaps (insurance) on these banks is soaring. Bond traders are describing the situation as "worse than Lehman". Banks like Credit Suisse and Deutsche Bank are losing billions. Deutsche's derivative book is 20 times German GDP and the Swiss banking system is 7 times Swiss GDP, excluding derivatives. It is not only bank client deposits which are at risk, but also any asset held in custody such as stocks and bonds. Now is not the time to hold any major assets within the financial system.

World economy rests on foundation of debt

We are now entering the very dangerous phase of the coming crisis. Confidence is quickly evaporating and fear replacing it. We know that the world economy is resting on a foundation of debt and false government promises. The world is now starting to realise that most of this debt is worthless and that governments' empty promises add up to nothing.

There are so many black holes in the world now that any morning we can wake up to find that a bank or a sovereign state has disappeared into one of these black holes. Yes, governments will create more negative rates and print unlimited amounts of money but to no avail. The process of assets imploding

could happen very quickly and unexpectedly. But whether it happens in a matter of months or it takes up to say five years, the world will look very different at the end of the coming calamities.

We saw the first phase of the downturn in markets in January. The current correction up is likely to be short lived. Soon the problems in the world economy are likely to resume with a vengeance leading rapidly falling asset markets and currencies. Gold and silver will move up very strongly.

The lucky few who can afford some physical gold will weather the storm better financially. But no one will escape the suffering that will hit the world in coming years.

Egon von Greyerz
Matterhorn.gold
GoldSwitzerland.com