

DEUS EX MACHINA

written by Egon von Greyerz | December 6, 2011

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With most of the world's major economies as well as the financial system bankrupt, there is only one solution that can save the world economy. Like in the Greek tragedies, Deus ex Machina is now the only way that the world can avoid a total economic collapse. This would involve God being lowered down onto the world stage and miraculously saving the plot.



DEUS EX MACHINA by Leo Lein – www.leolein.se

For those few who believe in this, may God bless them. But since this is a very unlikely solution most people will instead rely on governments and central banks to save us. **But how can anyone possibly believe that totally**

incompetent and clueless politicians and central bankers could solve anything. They created the problem in the first place and are therefore totally unsuitable to play the role of Deus. The main objective of governments is to stay in power and thus to buy votes. Therefore they are incapable of taking the right decisions. And the opposition, aspiring to power is even less suitable since they will lie through their teeth and promise the earth in order to be elected. (We know that there are exceptions like Ron Paul, but the voters will most probably find his medicine too strong to swallow.)

What about central bankers, can't they save us? Unfortunately any sensible person who becomes a central banker loses all his senses and becomes a prisoner of the political system.

Solution?

So if there is no Deus ex Machina and if governments or bankers can't rescue the world, who can and what is the solution. Let us return to the wise von Mises to look at the options available now:

“THERE IS NO MEANS OF AVOIDING THE FINAL COLLAPSE OF A BOOM BROUGHT ABOUT BY CREDIT EXPANSION. THE ALTERNATIVE IS ONLY WHETHER THE CRISIS SHOULD COME SOONER AS A RESULT OF A VOLUNTARY ABANDONMENT OF FURTHER CREDIT EXPANSION, OR LATER AS A FINAL OR TOTAL CATASTROPHE OF THE CURRENCY SYSTEM INVOLVED”

Ludwig von Mises

Mises is absolutely correct: *“There is no means of avoiding a final collapse of a boom brought about by credit expansion”.* Whatever politicians, bankers, economists or others experts say, **there is no solution to this crisis.** We have reached the end of the road and are now staring into the abyss.

The credit manufacturing system that started in 1913 when the Fed was founded, began its terminal phase in 1971 when Nixon abolished gold backing of the dollar. It has been clear to us for at least 20 years that the outcome was inevitable. It was never a question of “if” but only “when” it would happen. It is now clear to us that the false prosperity that the world has experienced by printing unlimited amounts of money will very soon come to an end. Thus the “if” and “when” conditions are now satisfied so the remaining question is HOW?

To try to answer this let's return to Mises: *“The alternative is only whether the crisis should come sooner as a result of voluntary abandonment of further credit expansion”*

To stop the money printing and credit creation would be the only sensible way of ending the failed quasi-capitalist, socialist experiment which is in the process of destroying the structure of the Western world. For almost 100 years we have lived on a system based on debt. This has created a false prosperity as well as false values. The transfer of capital from private

enterprise to government by massive taxation is approaching 50% in many countries (see table). The average for 18 industrialised countries is almost 40%. **This means that on average 40% of the productive economy is transferred to a non-producing entity (government) which wastes most of the money in the process of redistribution.** But not only that, since the state has taken over up to 50% of the economy in these countries, the desire to work, to strive, to take risk and to invent has been taken away from a major part of the population.

TOTAL TAXATION AS % OF GDP

Showing latest available data.

Rank	Countries	Amount
# 1	 Sweden :	54.2 % of GDP
# 2	 Denmark :	48.8 % of GDP
# 3	 Finland :	46.9 % of GDP
# 4	 Belgium :	45.6 % of GDP
# 5	 France :	45.3 % of GDP
# 6	 Austria :	43.7 % of GDP
# 7	 Italy :	42.0 % of GDP
# 8	 Netherlands :	41.4 % of GDP
# 9	 Norway :	40.3 % of GDP
# 10	 Germany :	37.9 % of GDP
# 11	 United Kingdom :	37.4 % of GDP
# 12	 Canada :	35.8 % of GDP
# 13	 Switzerland :	35.7 % of GDP
# 14	 New Zealand :	35.1 % of GDP
# 15	 Australia :	31.5 % of GDP
# 16	 Ireland :	31.1 % of GDP
# 17	 United States :	29.6 % of GDP
# 18	 Japan :	27.1 % of GDP
	Weighted average:	39.4 % of GDP

SOURCE: OECD Revenue Statistics

For a great many people it is now totally natural to rely on the state for their needs rather than on themselves. And the state needs to borrow/print ever increasing amounts to perpetuate this economy based on an illusion. This situation is totally untenable. Since any additional money printing will only exacerbate the crisis and make the final collapse so much greater, the swiftest solution would be let the financial system implode now. We need to reset the world to a level which is sustainable. The consequences of this

implosion would be a collapse of the financial system and a reset of debt to zero. Although this is unthinkable to any government or politician, it would be by far the quickest way to get the world back on its feet with no major debts, minimal government interference, and no central bank that can print money. It would be like a forest fire getting rid of all the dead wood. Out of that would rise masses of green shoots in the form of strong unchequered growth. The transition will of course be traumatic and the current generation will experience enormous hardship. But not voluntarily abandoning the money printing now will just delay the inevitable and the consequences will be dramatically greater and affect many future generations.

Anyone who has followed my articles will know my view that **governments worldwide are totally incapable of stopping the money printing**. This is their only means of staying in power and buying votes. But not only that, **this is the only method they know**. This has been their patent solution to all economic problems in the last decades. Not that this is new in history. Most empires have resorted to diluting the value of money by reducing the gold/silver content of coins or printing paper money. But as far as I know it has never before been done by so many countries simultaneously to such an extent.

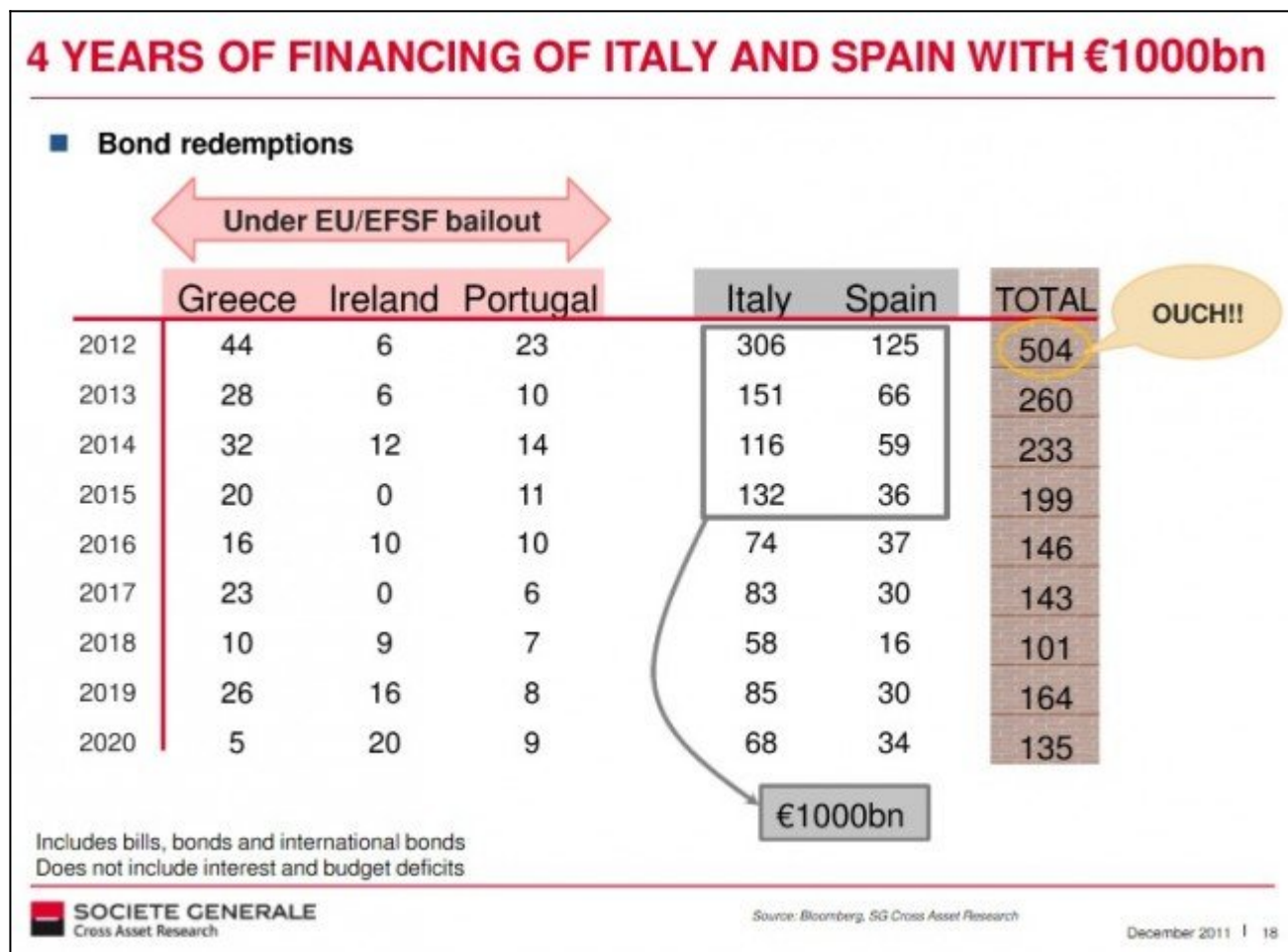
Since there won't be any voluntary abandonment of credit creation what will the likely outcome be? Again let's use Mises words: *"..... a final or total catastrophe of the currency system involved"*. The problem this time is that we are not talking about one currency or one country. No, we are talking about most of the world's major currencies. We have been used to measuring currencies and economies on a relative basis i.e. against each other. But this is a total fallacy since all major currencies have been in a race to the bottom for the last 100 years. Most currencies have lost between 97% and 99% against real money –GOLD – since 1913. And since 1999, most currencies have lost 80% or more against gold. So paper money has been a very poor measure of wealth in the last 100 years. Governments are creating credit and paper money and consequently through their fraudulent actions "stealing" from the people whilst at the same time increasing the people's dependence on the state. And the people does not understand that the value of paper money is declining continuously. But gold reveals the deceitful destruction of paper money. This is why governments do not like gold and try to suppress the gold price.

Endless Money Printing – QE

And how will the currency system collapse? The answer to this question is very simple – **through endless money printing**. There will be no lasting austerity programmes in any country that can print money. Governments are incapable of sticking to austerity measures since in the end that is a guaranteed way of losing power. As power is the main purpose of all governments, they will use any method to retain it. Within the Eurozone, individual countries can of course not print money but the ECB and the IMF will take care of that. So whilst world leaders are procrastinating and bickering in G8, G20 and all other "summit" meetings, it is absolutely guaranteed that the final outcome will be one QE package after the next.

Governments and central banks know that without limitless money printing there would be a deflationary collapse of the banking system and world economy.

The table below shows the financing requirements of the PIGS countries in the next few years. **Just Italy and Spain will require €1 trillion in the next 4 years and of that 1/2 trillion Euros in 2012.** Only printed money will take care of that.



For many years it has been absolutely crystal clear to some of us (sadly a very small minority) that many major sovereign nations are bankrupt as well as the world financial system. Banks are only surviving because they, with the blessing of governments, are allowed to value trillions of dollars of toxic and worthless assets at full value. And on top of that there are more than \$1 quadrillion outstanding in derivatives. These are outside the banks' balance sheets and there are virtually no reserves against them. The banks are netting the value down to virtually nothing and then applying a miniscule reserve against this net amount. First of all, the netting is only valid when the counterparty pays. When there is a counterparty failure, which is very likely in the coming financial collapse, gross remains gross and the \$1 quadrillion remains \$1 quadrillion. Secondly, a major part of the derivatives are worthless or not protecting the investors as we have seen with for example Freddie Mac, Fannie Mae, Lehmans and lately MF Global. MF Global had bought CDs to hedge their investment in Greek debt. But they hadn't

understood what they had bought and it turned out it offered no protection at all.

Hyperinflation

The "*final or total catastrophe of the currency system*" will occur as a result of the QE or unlimited money printing that will very soon start in the EU, USA, UK, Japan and many more countries. And this currency destruction will lead to hyperinflation as I have stated for many years. Throughout history, substantial government deficits leading to money creation or printing have always been the cause of hyperinflation. Because hyperinflation is always the result of a collapsing currency and not of excess demand.

To any thinking individual, it is totally incomprehensible that governments and central banks believe that an insolvent world can be saved by debt issued by bankrupt nations and then bought by the issuers themselves as there is no other buyer. This is the perfect recipe for self-destruction and "total catastrophe of the system."

IMF, EU and other failed monstrosities

Time and time again, the world creates massive costly, bureaucratic and unaccountable structures that have idealistic and totally unrealistic objectives.

Take the IMF for example. This is what their mission statement states: "*The International Monetary Fund (IMF) is an organization of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.*"

If financial stability, high employment, sustainable economic growth and reducing poverty are the objectives of the IMF, then they have failed on every single point. So here we have an organisation that receives/borrows money from mainly bankrupt states and then lends the money to countries that cannot or will not ever repay the funds. And in order to carry out this totally futile task, the IMF takes a major cut in between to finance its costly and failed operation. The world does not need monstrous and costly structures that totally fail in their mission. Thus, the IMF should be closed.

Turning to the EU, they state on their website: "***The main objectives of the Union are now to promote peace, the Union's values and the well-being of its peoples***". There are other stated objectives such as: "***sustainable development, based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment.***"

The EU or the EEC as it was first called was created in the late 1950s. This

was a prosperous period in the world economy based on real growth (not debt). As often is the case, politicians with illusions of grandeur create superstructures which only function in good times. The EU's main objective of creating peace and well-being of the people is now being severely tested. If we for example asked Spanish youth (50% unemployed) about their well-being or Greek people or the Portuguese etc, we would get a tirade of abuse and complaints about the EU. Instead of "creating peace", we are seeing major tension within the EU that could lead to serious conflicts. And as to "balanced economic growth and full employment", this has all come to an end. The false prosperity, mainly based on debt, has also come to an end and the EU can only survive intact with the aid of endless money printing. But even that would only be a temporary reprieve. The EU is a failed experiment which is extremely costly and inefficient. The economic ruin of Ireland, Greece, Spain, Portugal, Italy, France etc would not have happened to the same extent without the EU. Like all artificial fiat currencies, the Euro was doomed to fail. Without the Euro, countries like for example Ireland, Spain or Greece would have recovered much faster.

Final or total catastrophe

So we are heading to the final stage or as Mises says a "final or total catastrophe of the currency system involved". I don't think that even Mises envisaged at the time that this could involve a major part of the world rather than just one country. This is why this catastrophe will be unprecedented in world history and have consequences that will affect the world economically, socially and geopolitically for a very long time.

Wealth Preservation – Gold

Since 2002 we have advised investors to put up to 50% of their assets into **physical gold**, stored outside the banking system. **Gold has appreciated between 15% and 20% per annum** since 2002 depending on the base currency. And most stock markets have declined 70-85% against gold in the last ten years. In spite of this most major investor groups (institutional, funds, asset managers or individuals) own no gold. Gold is money and reflects the total destruction of paper money. But most investors do not understand gold. Common arguments I hear is that "**you can't eat gold**" or that "**gold pays no return.**" It seems that these investors prefer to eat paper money. And as to the argument that there is no yield on gold, who needs yield on an asset that has massively outperformed all major asset classes in the last 11 years. And if we look at 2011, gold has greatly outperformed stock markets in most major countries. Whilst stock markets are down between 1% and 24% in 2011, gold is up more than 20% against all major currencies. So in real terms (gold) all stock markets are doing very badly but still investors persist in riding these falling trends.

Gold outperforms all stock markets in 2011

Country	Index	Index % change	Gold in local currency % change
USA	S&P 500	- 8 %	+18 %
UK	FTSE 100	-13 %	+ 20 %
GERMANY	DAX 30	- 21 %	+ 20 %
FRANCE	CAC 40	- 25 %	+ 20 %
ITALY	MIB 30	- 29 %	+ 20 %
SPAIN	IBEX 35	- 20 %	+ 20 %
SWITZERLAND	SMI	- 15 %	+ 18 %
SWEDEN	OMX	- 22 %	+ 21 %
JAPAN	NIKKEI 225	- 19 %	+ 13 %
AUSTRALIA	ASX Ord.	- 15 %	+ 25 %
HONG KONG	HANG SENG	- 22 %	+ 19 %



Prices as at 25 Nov 2011



Stock markets will benefit temporarily from QE but it is still our view that they will fall another 90% against gold in the next few years.

The correction in the precious metals is now likely to be over and we should see the metals going to new highs in 2012. I had the pleasure of becoming acquainted with Alf Field at the recent Gold Symposium in Sydney where we were both speakers together with Eric Sprott, John Embry and Ben Davies amongst others. Alf is one of the few in the world, if not the only one, who knows how to apply the Elliott Wave principle successfully to gold. Alf's next intermediate target is at least \$4,500 and the ascent to this target could be rapid. That would probably mean a silver price of \$150. These technical forecasts certainly confirm the fundamentals as outlined in this article.

The world is in a total mess and there is absolutely no solution to this unprecedented crisis. The hyperinflationary depression that we will experience in the next few years will totally destroy the majority of the credit based wealth that has been created in the last few decades.

In order to preserve wealth and keep capital intact, it is critical to keep a major part of investment assets in precious metals held outside the banking system. But for investors who continue to follow conventional wisdom, they will sadly find that their investment strategy was merely conventional and contained no wisdom.

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