Our whole financial system is an illusion

written by Edward Maas | July 13, 2011

“Our Whole Financial System Is An Illusion“

‘The Matterhorn Interview’ – July 2011

The book author, financial commentator and entrepreneur Mike Maloney talks in this exclusive interview with Lars Schall for Matterhorn Asset Management in Zurich, Switzerland about: inflation/deflation, the flaws of the current monetary system, the upcoming rollercoaster ride in crude oil, and the biggest bull market in gold and silver ever.

By Lars Schall

Mr. Maloney, is a massive financial/economic storm ahead for us that will express itself basically through these four phases: a short-term deflation – inflation – a huge deflation – a hyperinflation?

Mike Maloney: Yes, I absolutely believe so. I think related to the recovery of the stock markets, we got something going on in the United States that I refer to as a “Dead Cat Bounce“ – this is an old stock market term that goes back to the crash of 1987, where a stock market trader, when he was asked about the crash, answered: “Even a dead cat would bounce if you drop it from a high enough point.“ This means if a stock is so ridiculously overvalued, then when its bubble pops and it crashes, it goes down a certain amount and then investors come in to start buying what they think are good deals, because it’s now at half of what the stock was previously selling for, but they aren’t measuring the fundamentals: is this stock really a value measured in things like of P/E ratio (price-to-earnings ratio) and dividend yields?- the fundamental measurements of whether the stock is a bargain or whether it is overvalued. They aren’t looking at that. They just look at the price and they come in thinking they are scooping up deals only to find out later that the stock still needs to fall to go back to fair value. So those people that buy cause the stock to rise, then the stock runs out of steam or energy and it starts to roll over and decline again.Well, entire economies are doing the same thing. We were in a bubble that was a worldwide bubble. It’s a credit bubble that has caused all these other bubbles in other asset classes like stocks and real estate. Those bubbles have begun to pop, but by any measure of reasonable value the stock markets and the real estate are not done of falling yet. We’re still in a bubble. The crash of 2008 was just a speed bump on the way to a major accident. In the United States and many, many other countries around the world we are now in this “Dead Cat Bounce.“ The Federal Reserve for example created a whole bunch of currency. For the bailouts they’ve created more than a trillion of dollars of base money – base money is the currency in circulation, the paper dollars and the deposits that the banks have at the Federal Reserve, which are redeemable in paper dollars. These are not the dollars that the banks create with fractional reserve lending, which magnifies the money supply, but the Fed more than doubled the amount of base money, it went from 825 billion to 2.2 trillion paper dollars.

What did that?

Mike Maloney: Well, we had a short-term deflation, and when Ben Bernanke, the Chairman of the Federal Reserve, created all that currency, that currency went to bailout the banks, and the banking sector let the stock market rebounce, but now the stock market runs out of steam again. Not only in the United States, but also in Europe and other places, because the stock markets are since the year 2000 – and especially since the fall of 2008 – increasingly linked with each other – if we go down, they follow. So we had the threat of deflation when the markets crashed, and I wrote in my book "Guide to Investing in Gold and Silver" before all that happened, that to this threat of short-term deflation Ben Bernanke would overreact, create a lot of currency and that would cause mild inflation, which we had now. And now we should go into a real deflation, a contraction of the currency supply. That means there will be less dollars and probably less euros in existence.That will be a true deflation. The prices start to fall, and even though prices fall everybody has less currency. So the economy slows down. And that is then Ben Bernanke's greatest nightmare. What I said in my book is that he will try to print his way out of this true genuine deflation – and you can already see this with this QE2, with which they are buying U.S. tresuries directly from the government and creating the currency that didn't exist to pay for the treasury notes. That is a sign that the Federal Reserve is doing emergency panic measurements. There is something fundamentally wrong with the global economy, and all Ben Bernanke is doing is that he is putting wall-paper over it so that the people don't see it.

As you have just mentioned in your answer, we're in the midst of a global credit bubble. Most people do not understand our current money system and how currency is created. Could you make clear from your point of view why the system has some major flaws right from the beginning?

Mike Maloney: Yes. Well, the world monetary system is indeed fundamentally flawed. I am saying for a long time now that if you are looking back in modern history, let's say roughly 200 years, that every thirty to fourty years the world has an entirely new monetary system. This is a normal thing. And the reason is because this monetary systems are man made systems, and human beings can not properly account for and balance all of the transactions that go on in a free-market society. So you're trying to create a monetary system and people will have the arrogance and audicity to think that they are smarter than the free markets. When a small group of men, governments and private central banks decide what is money, what currency is used and how much interest rates are going to be – what the market place should be deciding -, at that point the system is eventually doomed because a whole lot of energy will be built up misallocations and disequilibria until the whole thing becomes unmanagable and the whole system falls apart. I believe this is what we are seeing today.Today we have a hokus pokus money system, which was invented originally by the Bank of England, where you borrow currency into existence. This is what people don’t realize: our whole financial system is an illusion. It is merely based on the confidence of the public. The “fiat“ in “fiat currency“ means an order given by an authority that has the power to enforce that order. A government says this is our currency and it is going to be worth something because we make our taxes only payable in that currency. That is what gives people confidence in that currency. The only reason a dollar or a euro buys something is because in your experience it bought something yesterday, so you think it buys something tomorrow and therefore you accept them. Otherwise it is just a piece of paper with numbers on it. The entire economy of the planet is psychological. It doesn’t really exist physically.A long time ago, the currency that we used was real money, it was gold and silver, and its value was simply derived by how rare it was and how hard it was to find and dig up and mint it into a coin. It was a certain amount of rarety and a whole bunch of labor, and that gave it value. Today what we do is a government will create a bond – a bond is just an I.O.U.: you loan me one trillion dollars and I promise that over a thirty year period I pay you back one trillion dollars plus interests, so I will pay you two trillion over that thirty year period. And then the central bank buys that bond – here in the U.S. we do it through the Open Market Operations, it’s a bit like a shell game: first the banks buy it and then the Fed buys it from the banks. What is really going on is the Treasury issues I.O.U.’s and eventually the central bank acquires those I.O.U.’s by printing currency. They basically just invent dollars, which is just a claim cheque – so basically it’s an I.O.U. for an I.O.U., and this swapping of I.O.U.’s indebts the public. We are borrowing prosperity out of the future and promising to pay it back. Basically, our taxes today are payments for the borrowing of yesterday. (i)

And isn’t it also a bit bizarre that the most dominant Central bank in the world during past 100 years, the Federal Reserve, is actually a composition of private banks, who profit from this money creating process and growing indebtness of the public, for example via interest rate payments?

Mike Maloney: In the United States people are starting to wake up now because of the Internet and all the information that is going on, but back in 2000 I would say less than 1 in 20 people knew that the Federal Reserve is private. Almost everybody thought it was part of the U.S. government. Now it’s 1 in 4 that I talk to that know that the Fed is private. Basically, the only thing you have to do is to go to the Federal Reserve website, enter the page of Frequent Asked Questions and read the answer to the question: “Is the Federal Reserve private?“ And their answer is: “No, it isn’t, but maybe yes, but sort of no.“ It is very vague, it just goes round and round in circles, and you really can’t tell what it means. But then you read the answer to the question: “Does the Federal Reserve has stock holders?,“ and the answer is: “Yes, and they get dividend.“ Well, how many federal agencies are out there that have stock holders?The answer is: None. A stock holder is the owner of a company. Of course, since the Fed was created in 1913, there had been all these mergers so that you can’t really tell who owns the Fed, but the whole monetary system is sort of a scam now, which is even absurd, because there is in fact much more debt in existence than money to pay it!

Is it via interest rates connected to exponential growth?

Mike Maloney: Yes, and this exponential growth means that it eventually leads to hyperinflation. And Germany knows something about hyperinflation, you have been through it before.

It is part of our collective memory.

Mike Maloney: Yes, and the whole system one day has to self-destruct.

One aspect of the big picture currently are precious metals. Why is it important to fight gold and silver in our fiat money environment? Is this by and large a delusion operation?

Mike Maloney: The central banks are fighting it, but they will ultimately lose this manipulation of the price. That won’t happen too soon, though we see right now the big effort to overwhelm JP Morgan in the silver market in order to cut them into a short squeeze and to expose the manipulation. However, whenever the free markets get manipulated, energy builds up and when it is finally released the free markets overwhelm the manipulators. The bigger the energy, the bigger the reversion. When the central banks and the big bullion banks lose control, the higher the prices of gold and silver will go. If silver had been for example $30 all throug the 1990’s, there would be plenty of silver above ground, it would have been effordable to mine and there wouldn’t be less of an opportunity now in silver.

Would you say then in general that the price suppression of gold and silver is ironically a good thing for investors in the sense that you can use the energy of the opponent for your advantage like they do in martial arts?

Mike Maloney: Yes, using the energy of your opponent to defeat him – that is a very good analogy! I have never heard that one before, but it is a very good one. Thank you very much, it’s excellent!

You’re welcome. (laughs)

Mike Maloney: And that’s exactly what we’re doing. I believe the closest thing to a sure thing that has ever existed during my lifetime is gold and silver revaluing themselves and gaining in purchasing power against all of the fiat currencies that are being created. The manipulation is one of the things that has caused this enormous opportunity. What the price suppression does is: the more they suppress it, the greater the shortages become. Believe me, once the price explodes there is going to be a gold and silver rush like the world has never seen. In the 1970’s bull market there wasn’t really such a thing like a gold investor, gold wasn’t thought about as an investment. Gold was just a safe thing to keep, but people were not buying and holding it during the long-term knowing that one day it would go into overvaluation and purchase a whole lot more stuff in the future. Moreover, only 10 percent of the world population participated in that bullmarket – it was Western Europe and North America. In the USSR and China there was not one single investor. That has changed dramatically compared to today.Basically, everybody in the world can buy gold now, and the price is set in more places than just in London and New York, as it was back then. Now you have for example the Shanghai Stock Exchange. Also today everybody has an investor mentality. So you have ten times the available population that can buy, and within that population you have a hundred or maybe a thousand times more people who have an investor mentality. They are looking for the next big investment that is going to either secure their future or retirement, or if they are younger they are dreaming of that Lamborghini that they want to buy. Their question is: what is the next big thing that is going to have some growth?In the 1970’s the people were still trained as savers, not investors. They all got punished through the 1970’s and the 1980’s, whereas speculators were rewarded. And now you have a generation who know that they can not retire on the money that they just put on a savings account. They have to open up some sort of brokerage account, they have to invest in real estate, they all have to do something to protect their wealth.Investing has become a sport in places like China. People sitting in rooms and watch the ticker go by on the TV in order to place their bets. It’s a completely different world. So you have ten times the population each with ten times the currency, and within that population you have an investor mentality. When the world comes rushing back to gold and silver, and they will, it will be mind boggling and breath taking beyond anything you can really imagine right now. People ask me all the time how high gold is going to go, and so I had to put a price on it because when I said it would buy 35 times more stocks giving a Dow Jones to gold ratio of 1:35 people didn’t understand what that meant. I finally came up in 2006 with a price of $6000 per ounce for gold.

And for silver?

Mike Maloney: Well, it should overshoot the historical mean of the silver to gold ratio of 1:12, and with silver being more rare than gold there is the possibility that there will be a panic of people coming into silver. On that day when silver will be much, much higher than most people say it will go, the world is going to learn that the available silver for investors to buy on the exchanges and at the dealers is less than gold, and when the public learns that it is then entirely possible that silver is going up to or even exceed the price of gold. It won’t be along-term thing, it will be a short-term spike, and I am not saying that it will happen 100 percent, it would take a panic rush into it, but I guarantee you: when gold and silver will go into their bubble they will dominate the news on the financial channels just like when real estate was in its bubble or in 2000 when tech stocks and Dotcom stocks were in their bubble. All you’ve heard back then was: tech, tech, tech, and: Dotcom, Dotcom, Dotcom. The same dynamic will happen when gold and silver are in a bubble, and everyone will learn that the available supplies of silver are less than the available supplies of gold, and when the majority of people rush into silver because it is more than a bargain compared to gold you could see this price spike.When I came up in 2006 with the gold price of $6000 per ounce, that was the price it would take for gold to hit the same value it had against all the U.S. dollars it had in 1980 and 1934, when each time the value of the gold at the U.S. Treasury equaled the value of all the paper dollars that had been created plus the value of all the outstanding revolving credit. We would just see history repeating itself. But since then Ben Bernanke has created all these new base money that we were talking at the beginning and now it would take $15.000 per ounce. It’s a moving target and the price doesn’t really mean anything. It’s all about value. Because if we go into a hyperinflation, we measure the price in trillion, quatrillion, sextillion of dollars per ounce, it won’t be measured anymore in hundreds, thousands or millions of dollars, it’s going to be far beyond that. And when I say that a lot of people think I am crazy and that I don’t know what I’m talking about, but it happened before, it happened with the German Reichsmark and many, many other times, and the thing is: there is no example of any unbacked currency, any fiat currency that did not collapse.The bottom-line is: When the dollar is in trouble, the whole world is in trouble. And seen from that perspective, I believe that we will experience in the next years the biggest bull market and bubble in gold and silver ever, whereas in 2000/01 gold and silver were the most undervalued assets ever throughout their history – and paper assets such as stocks were most overvalued.

As you know one thing that attracts attention to the silver market is Max Keiser’s “Crash JP Morgan, buy silver“ campaign and his Silver Liberation Army. What’s your opinion with regards to this action?

Mike Maloney: I think it’s really good, though I don’t think it’s going to win right now. And to be frank: I hope it doesn’t, because when JP Morgan and the other manipulators win again in the short-term, the price of silver goes down and that gives us the opportunity to buy more of physical silver and take it off from the market. They are speculating, they are going short on silver, they are betting that it’s going down, but in order to do this either they need to borrow real silver and sell it into the market or to make that short selling they sell paper silver into the market that says: I.O.U. silver – and some day they got to have to pay for it.Now, if the price falls and they can then repurchase those I.O.U.’s back at lower prices as they sold them for they’re winning on the price difference. What they have done is that they’ve fleeced the public that is buying futures contracts, SLV and GLD. Their wealth has been transfered from them to JP Morgan. But if you’re buying physical silver and gold and the price falls, you still got it, you got your physical silver and gold, you don’t lose, but you can take the currency that you were accumulating in the meantime and buy more for a lower price. That is what I’m doing: everytime the prices go down, I just try to add some more to my position. And therefore, I hope the price falls again. Too much is never enough. (laughs)

But in order to cause people to buy physical silver, Max's campaign is really good, isn't it?

Mike Maloney: Yes, and so is the manipulation: it is real good to acquire physical gold and silver for modest prices and it gives people more time to do it. Of course, some people say that I am predicting that the value of physical gold and silver will ultimately go much higher because I have a bias as a precious metals dealer. Well, I tell you: I am a dealer because I have a bias, I don't have a bias because I am a dealer. I was an investor first, I bought gold at $325 in October of 2002 and then soon after I began to buy silver as well – and by April of 2003 I was fully invested. I realized this would be a long-term thing for many years to come and so I decided to commit my entire life to it. I became a dealer in 2005, I also started to write my book in 2005, it was finished in 2008, and so there isn't anything that I do that isn't somehow connected to gold and silver and betting that both things are going higher in the future measured in how much stuff it buys. Again, the price doesn't mean anything. The price can actually fall and still gold can buy more in a deflation.I was first an investor and I developed all of my opinions before I became a dealer. So yes, I have a bias and that is the reason that I am a dealer, but I don't have a bias because I am a dealer. It's the opposite. I want to make that really clear, and I also want to make clear that I haven't a single investment except in gold and silver. Those two things are my only investments at this point. Of course, I have my book and my websites, but these are based on years of research on the monetary and financial system as well as on gold and silver. I thought in the past: Well, there are no sure things in life and especially not in finance, but the thing closest to a sure thing is that gold and silver will buy more stuff compared to all fiat currencies. And if the manipulators of precious metal prices lose control at the same time as the currency markets are crashing and the real estate market is really crashing, the revaluation of gold and silver will become astronomical. Nevertheless, like James Turk says: "The U.S. dollar is a poor measuring stick," because it keeps on changing. Everytime you want to measure something with it, it is a bit smaller than the day before, so it takes more units to buy the same thing.

That reminds me a bit on what the German poet Heinrich Heine once said mutatis mutandis: "When it's night you can use a blind man as your guide, but when it's daylight you can use your own eyes."

Mike Maloney: Yes, you've got to remove the smokescreen in order to see what's really going on with value by measuring things not with currency but other things. You have to measure the stock market for example by barrels of oil or by ounces of gold.

Since both the financial system and the economy depend on the supply of oil and energy per se, insofar they inhibit the growth that the financial system requires to work properly: where do you see the price of crude oil going? Will this become a rollercoaster ride in the next years, too?

Mike Maloney: Yes, in my book this is exactly the way how I've described it.

It’s going to be a rollercoater ride indeed. Our prosperity, the economies, the price of crude oil are all coupled to that rollercoaster ride. The price of crude oil isn’t just dictated by supply and demand, it is also dictated by the exchange rates and the inflation or deflation of the currency, so the purchasing power of the currency. We can have the price of oil go down if there is just less currency and the purchasing power gained or even if there is more currency. If people flee away from other currencies like the euro and rushing toward the dollar, then the exchange rate rises, the commodity markets tend to fall and that causes also the price of oil to fall. There is a whole lot of different scenarios where I can actually see the price of oil rise or fall temporarily even though it isn’t caused by a fundamental changed supply and demand situation. In general, demand keeps on going up, but discovery has not gone up to match with production. Most people agree that we are near the Peak Oil and it doesn’t mean there’s less oil pumped in the future, it just means that the price has to go up so that you can make smaller and smaller discoveries practical. Eventually oil production will fall, but if the price goes up to $500 per barrel, I guarantee you that production will increase! (laughs)

Yes.

Mike Maloney: The price is the balancing act to determine it. But as we’ve mentioned before, our monetary system requires infinite expansion – you always have to borrow more currency into existence than you’re extinguishing every single month or you’re going to deflation because you get trapped backwards in the debt that you owe. There is debt owed on the currency supply. Every euro, every dollar is all owed back plus interest, and because of the interest more is owed back than exists. So you always have to borrow more into existence every month, but our real prosperity is due to cheap energy. If you look at the industrial age and the quality of life that we’ve enjoyed, the prosperity began to increase when we began to mine coal. And then someone punched a hole into the ground and oil spewed out, and when that happened soon afterwards the cheap energy caused a big boom after World War I – the entire world started to participate on greater and greater prosperity due to that cheap energy.It allows us to ship goods and services, it allows us to manufacture, it allows us to drive and heat our homes and other such things at a very low cost. If we would still use hard money, gold and silver, without fractional reserve banking, the people would see that the true price for the costs of living has gone down. We had mild deflation all the time because it required less and less working hours to enjoy a greater standard of living for the amount of energy that we have to put in to that prosperity. Where does it all come from?It’s from this cheap energy, it’s not from the exponential monetary system. Our exponential monetary system was invented and is a method for the banking system and the government to transfer some of that prosperity that we’re enjoying away from us without us seeing.

Well, oil is the backbone of globalisation, of our food supply and also when you take a look at the population growth on a global scale it is related to the discovery of crude oil – when that happened the whole thing gained

momentum.

Mike Maloney: Yes, you are absolutely right, Lars, we also developed medicine, less people die, more people live longer, and that's due to oil and cheap energy. At a certain price, I'm sure, alternative energies will become affordable and competative, but there is no perfect answer to our energy and environmental problems. And in the meantime the economy will slow down and our exponential monetary system will suck continuously so much energy out of the economical system because of this interest that is due all the time on the money supply – it is incompatible. The whole thing has to implode one day! (laughs)

No veto on this one from my side. – Well, here's the final question and it is divided into a and b: a) do you see a new monetary system coming, and b) given the flaws we were talking about, how should it look like based on your point of view?

Mike Maloney: I've been talking about this for years and I believe, as I have mentioned before, that there is a new monetary system every thirty to fourty years. It's normal and is inevitable as long as the free markets are not allowed to pick what money is and what interests are. If they are not allowed to operate, then whatever monetary system man has designed will fall apart. I see a new monetary system coming before the end of this decade. This decade will encompass greater changes than any of us who is alive has ever experienced – even those who were already alive to experience the Great Depression. The changes that we are going to see in this decade will be greater because of the convergence of all the different cycles and the enourmous transfer of wealth that is going on into one point in time.If you look at what is happening, the new monetary system will be most likely somehow incorporate gold. There is actually no reason why we can't just use gold and silver as money. I do expect if the free markets could choose the money, then they would indeed choose gold and silver. But I will not say what is best, I am not that arrogant. Therefore, I prefer not to say how the monetary system of the future should look like. The only thing I would like to suggest is that the free markets should be allowed to choose it – not the G20 and central banks in private hands.

Thank you very much for taking your time, Mr. Maloney!

Remark:(i) It is of interest related to this answer by Mike Maloney what then Federal Reserve chairman Alan Greenspan stated to the Senate Banking Committee in May 1999: "Gold still represents the ultimate form of payment in the world. . . . Fiat money, in extremis, is accepted by nobody. Gold is always accepted."

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