Why Gold Will Rise – The Financial System Has Changed

written by Matthew Piepenburg | March 16, 2022

Despite massive price volatility of late, gold will rise.

The Perfect Gold Storm

Not long ago, I wrote a piece on why **gold was *not* rising**.

As I said then, and will repeat again now, gold's then-yawning price moves in an otherwise ideal inflationary and negative real rate environment was just a momentary calm before the storm.

In other words, gold's rise –and perfect storm—was coming.

Well, that storm is gathering strength and gold will rise—but not in a straight line.

Despite inevitable (and extreme) volatility (war and inflation-driven) and legalized price fixing (including $100 intra-day price moves) from the increasingly **discredited *paper* COMEX markets**, gold will keep rising as CPI inflation hits 7.9%.

Nearer term, gold's price will gyrate depending on whether tensions in the Ukraine escalate or de-escalate.

But as we discuss below, Western financial responses to the crisis in the Ukraine have just changed the global system—yet no one noticed. Longer-term, this bodes extremely well for gold and its potential to rise.

But First: A Nod to Goldman's Jeff Currie

Although it's easy to **poke fun at Goldman Sachs** (as I've done in the past, apologies to my daughter), I am pleased to confess that Jeff Currie, Goldman's Global Head of Commodities Research, has correctly addressed what he calls "the perfect storm for gold."

That is, a near-perfect convergence of three key gold demand forces (or "weather fronts") are in now in motion.

The first of these weather fronts is the growing (and inflation/recession fear-based) retail investor demand for gold. ETF trade volume is ripping north and poised to increase by another 600 tones.

The next weather front is coming from central bank gold buying, which is already up 750 tones for the year and marking *an all-time* record.

China and Turkey, for example, are buying gold in a not-so-surprising move to de-dollarize (see below) as other nations, like Brazil and India, are buying gold to diversify.

The third and final weather front is the spiking demand for physical gold, lead primarily by China and India—and let's not forget Russia, whatever you may think of it…

All three gold channels (retail, central bank and physical markets) are objectively *the strongest they have ever been,* stronger even than in 2010-2011 when gold rallied by 70%.

Goldman's price target for gold is now $2500—a substantial rise.

We think it will go much higher…

Why?

Because regardless of what you think of Putin, Russia, the absolute horrors of war, the confusion of headlines or the wisdom of the West, the EU and Uncle Sam just shot themselves and the global financial system in its collective foot—and no one even seemed to notice.

Weaponized Finance—Be Careful of the Safety Trigger

Despite the fact that Putin had been warning the West for *eight years* to keep the Ukraine out of NATO with the same passion that Kennedy had warned the Soviets to keep missiles out of Cuba, the West somehow seemed shocked that "brilliant statesmen" like Kamala Harris could not outthink Putin.

Despite nearly every U.S. State Dept official since the late 90's warning that a Ukraine in NATO would be suicide, the West is feigning shock today.

Rather than diplomatically addressing the Ukraine NATO alliance (which is about as obsolete in the post-Stalin era as a rotary dial phone), the Vice President (chosen for optics rather than experience) landed in Europe and doubled-down on a bad NATO hand (as well as embarrassing grasp of European geography).

War rather than compromise quickly followed.

But unlike Iraq, Syria, Libya or even Afghanistan (where US doubling down has been an epic failure), the great minds of the West decided to play chicken with a nuclear power, which, well complicates things, no?

Given that conventional proxy wars aren't so easy when dealing with a *nuclear* adversary, the West's only viable option once the inevitable (Putin-pre-warned) invasion of the Ukraine occurred, was to *weaponize finance* rather than flirt with nuclear red buttons.

But as anyone familiar with weapons knows, once you unlock the safety trigger, unforeseen risks emerge.

And unbeknownst to almost everyone ingesting the main stream media's daily pablum, the financial weapons unleashed by the West have dangerous consequences.

In fact, and while most of us weren't looking, the entire financial system of the last 4 decades (i.e., globalization, an artificial bond bull market and manipulated disinflation) just died, soon to be replaced by a multi-polar and multi-currency new inflationary world—all of which point toward a notable rise in **gold price**.

How did this happen?

Well, let's ignore the politicians, the COMEX and standard headlines and examine cold reality.

The Catalyst No One Sees

As the holder of the global reserve currency and the almighty USD, Washington has been able to export inflation and bully little guys like Iran and Venezuela with all kinds of clever financial sanctions with relative impunity/effect for years.

But when you start poking at Russian (and indirectly, Chinese) tails by freezing FX reserves, you unleash a world of mess and a domino chain of unintended (but obvious) consequences which are far too complex for the 30-something financial journalists at the NYT or CNN to grasp.

Recently, and with all the chest-puffing of bringing a knife to a gun fight, the US and EU bravely announced that sovereign debt held as FX reserves outside one's own national borders ($7-8T) is now subject to seizure by Uncle Sam and Aunt Marianne (i.e., the EU).

Such bold financial saber rattling is impressive; but by totally discrediting sovereign debt as an FX reserve, the US and EU have effectively just announced to Russia (and the world) that they are killing the post-war financial system—which also means you should **buy more gold**…

Such grossly misunderstood moves by the West are now forcing Russia (and soon China) to do what they've already been advocating for the last decade, namely forcing the global financial system toward a reserve neutral asset (gold) that floats in price in all currencies.

After all, if the West can freeze Russian FX reserves (i.e., its accumulated trade savings) today, China now clearly knows the West can and will do the same to them tomorrow if they, for example, look sideways at Taiwan…

An no, this doesn't make me "Pro-Putin" or "Pro-China," just pro candor.

Even if the horrific war in the Ukraine de-escalates, the extreme financial moves made by the West since late February will never be forgotten. That genie can't be put back into the bottle.

Even the Swiss decision to abandon centuries of neutrality by joining "woke" (i.e., US-pressured) sanctions against Russia is the equivalent of a placing a massive, neon flashing sign atop the Matterhorn which reads: "Don't buy CHF, Buy Gold."

In short, the financial world has now changed, and there's no turning back.

Let's see why.

De-Dollarization Coming Full Circle to Bite the West

Russia, and soon China, must now turn to SWIFT alternatives which will not only alter the global payment systems, but undermine the USD's global reserve status, which, well, kinda matters…

This is not just my/our humble opinion, but warned as well by Citadel's chief executive and JP Morgan's Jamie Dimon.

That is, the West has just forced Russia even further into the arms of China in more ways than one.

Rather than look toward northern California for software solutions, for example, Russia will look toward China.

But as Dimon warned, there are far greater consequences ahead as the USD becomes less "global" less of a "reserve" and less of a "currency."

Dimon's concerns, moreover were shared by President's Biden's former boss in August of 2015, when President Obama accurately warned of the "unintended consequences" of a SWIFT/financial war:

"We cannot dictate the foreign, economic and energy policies of every major power in the world. In order to even try to do that, we would have to sanction, for example, some of the world's largest banks. We'd have to cut

off countries like China from the American financial system.

And since they happen to be major purchasers of our debt, such actions could trigger severe disruptions in our own economy, and, by the way, raise questions internationally about the dollar's role as the world's reserve currency. That's part of the reason why many of the previous unilateral sanctions were waived."

In short, somewhere between 2015 and today, American common sense, leadership and options took a nose dive.

What's also about to take a nose dive is the American economy in general and markets in particular.

Do you want to see why?

The FED—No Where to Go but Crazy

Dramatic words are not enough, so let's stick to dramatic facts and a quick glance at a simple graph of the Fed's embarrassing balance sheet…

Although the media and headlines ignored the staggering repo crisis of September of 2019 as a minor "glitch in the plumbing," it was, in fact, a neon flashing sign of a looming/brewing credit and (hence) financial crisis.

When US commercial banks in the autumn of 2019 were staring down the barrel of a rising USD and rising (i.e., unaffordable) interest rates, they stopped trusting each other's collateral to make over-night loans.

As expected, the Fed stepped in as the lender of last resort and began mouse-clicking hundreds of billions of dollars out of thin air per month to backstop the bank(er)s who created the Fed back in 1913.

Such money printing explains the parabolic (and fatal) move up and to the right of the balance sheet plotted above.

That is, the Fed had to create money to buy its own Treasuries which foreign buyers no longer wanted.

But what almost no one is noticing today is that the problem's facing the Fed and Uncle Sam's otherwise unloved and unwanted IOUs in 2019 have only been made exponentially worse.

That is, the recent actions by the US and EU to Freeze Russian FX reserves for not towing the Western line is telegraphing to the rest of the world (i.e., China) not to trust US Treasuries.

Needless to say, if US Treasuries are now the ugliest girl at the global dance, who else is gonna buy them, and with what money?

The sad answer is simple: The Fed will buy them with more debased dollars created out of thin air.

Crazy?

Yep.

Recession and Leverage Ahead—Will Gold Rise?

Given the sad yet media-ignored fact that the US (with a **debt to GDP ratio of 122%**) is effectively broke yet spending like a teenager with Dad's Amex card (nod to my son), the future, as well as policies ahead, are not hard to see.

It's worth asking how US spending for entitlements, defense and treasury outlays will be paid for.

In short: Where will the money come from?

Will Uncle Sam cut spending?

Given that US spending accounts for 25% of its GDP, any spending cuts will put the US in recession for the simple reason that such cuts will send yields and rates up and hence bonds and stocks to the basement.

Can the US raise taxes? This too would only slow growth and invite recession.

Can the Fed raise rates to finance Uncle Sam's deficits?

No, because his **bar tab is too high** to stomach rising rates, and that too triggers a recession and a debt crisis.

So, what can Uncle Sam do?

As realists rather than paid (i.e., censored) journalists, we here see only one or two obvious yet sad options ahead, all of which make an equally obvious case for a rise in gold.

First, it’s highly likely that the Fed will suspend SLR (Supplementary Leverage Ratios) previously imposed on commercial banks.

In plain English, this just means banks will be allowed to use more leverage to buy Uncle Sam’s debt from within at no charge.

No shocker there.

As we’ve written elsewhere, governmental guarantees of commercial bank lending are *already* in play –and this just means more leverage, more debt, more risk and more **autocratic rather than natural markets**.

In addition, expect more QE as well, which means the inherent value (as opposed to relative strength) of the USD, like all other fiat currencies, is getting weaker by each inflationary second, minute and hour.

Got gold?