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Something to Think About

OAKWORTH CAPITAL BANK

COMMON CENTS

This week, a friend forwarded an article by Porter Stansberry to me. In case the name isn't familiar, Stansberry is a financial commentator who made a lot of hay a few years ago by predicting the impending bankruptcies of GM, Fannie Mae, and Freddie Mac. In truth, folks had been discussing GM's inevitable restructuring for years, and the question wasn't whether Fannie Mae and Freddie Mac's balance sheets were upside down; the question was whether the government would guarantee their debt, as investors had long thought it would.

Even so, I suppose kudos are in order, to some degree. He was certainly one of the loudest voices shouting out in the wilderness about such things. However, that was then, and this is now. As you know, the investment industry always asks "what have you done for me lately?"

Well, it seems Stansberry is one of the many predicting the ultimate collapse of the US dollar as the world's primary reserve currency. After all, clearly the level of US indebtedness is unsustainable, and all of that. Of course, like others, he believes said collapse will cause the entire US system to completely fall apart. One can only imagine the dystopian world in which we will live after this happens. Will the sun even shine? Or will gray skies spew forth showers of ash and dust, as we migrate in our rags to where the food is?

I completely agree with all the Doomsday prognosticators our there: one day, the US dollar will not be the world's primary reserve currency, one day. I am as certain of that as I am the nose on my face. The question remains: just what will replace it? I mean, all of the world's currencies have the same fundamental problem: they are intrinsically worthless and pitiable stores of value.

After all, 50 years ago, in 1965, the accepted price of a troy ounce of gold was $35-36. Today, it is around $1,200. Hey, an ounce of gold is still an ounce of gold. So, what has changed here? Obviously, the value of the dollar has gone down, as it now requires around 33 times more of the things to buy that same ounce of shiny stuff.

The question the gloom & doomers can't answer to my satisfaction is: what is the current alternative to the US dollar? The yen? The pound? The euro? The Chinese currency isn't convertible, so that is off the table for now. Gold? Silver? Beanie Babies? Baseball cards?

I'll tell you what would happen. Folks would still need a functioning reporting currency, so we would still have the US dollar. The price of whatever agreed upon commodity backing the thing, say gold, would go through the roof. This would make it highly impractical to use the commodity as a medium of exchange, and folks would continue to accept the paper stuff in order to facilitate transactions.

Frankly, the global economy has been off the "gold standard" for so long, it would be almost impossible to go back on it. If the US does it, everyone has to do it, and there just ain't enough potential gold reserves our there to make this happen, for practical purposes. After all, when you add up all the reported 'foreign currency reserves' at central banks around the world, you come up with about $13 trillion, including gold.

Now, according to Thomson Reuters' GFMS team, humans have mined about 1.6 billion troy ounces of gold since the dawn of mankind, for all uses. At, let's say, $1,200 per ounce, that works out to

Inside this issue:

You can pay me when you see me again, Josey Wales

Granny Hawkins

Something to Think About Cont.

be $1.44 trillion. As you might imagine, global gold volume estimates vary wildly, as folks tend to hoard the stuff and most of it is in jewelry in any event. But think about that. $13 trillion in reserves, and only about $1.44 trillion in gold to potentially back it.

While it doesn't quite work this way, let's have some fun with the math. In order to full cover those reserves with gold, the price of the shiny stuff would have to increase to about $8,125 per ounce. Hmm. The US officially has 8,133.50 metric tons of gold reserves, which it values at $42.2222 per ounce for some reason. So, for accounting purposes, using these numbers, the US Treasury has around $11 billion in gold. However, if it shot up to $8,125 per ounce, the Treasury would have around $2.125 trillion at market price.

Therefore, having the dollar collapse to the point we would be forced to go back on some measure of gold standard could result in a $2 trillion windfall for our country! Alone, this would cause the US dollar to appreciate, which would make us wonder why it collapsed in the first place.

Bring it on….However, it will never come to that, and it won't come to hyperinflation either.

On my desk in my office, I have a $100 trillion dollar note from the Reserve Bank of Zimbabwe. You should have seen the look on our previous receptionist's face when I told her I wanted to deposit it into my checking account. It was priceless, and not worthless like the note itself.

Throughout history, hyperinflation is relatively uncommon, and generally happens in countries torn apart by war or some form of government upheaval, be it revolution or just good old-fashioned internal disintegration. It doesn't seem to happen in countries with relatively stable governments and/or economies.

In hyperinflationary economies, the powers that be felt it necessary to literally print money in order to make up any budgetary or perceived economic shortfalls. Obviously, this led to a decline in the value of the currency, which only exacerbates the situation. In essence, once they cranked up the printing press they couldn't stop until much of the remainder of the wealth in the economy had been destroyed.

For instance, consider Germany after World War I. In January 1921, there were 66.62 billion mark banknotes in circulation. Less than 3 years later, in November 1923, there were 400,267,640,301.85 billion mark banknotes floating around out there. That is over a 6 billion% increase, and I am not sure how to accurately type out that percentage.

However, even that is child's play compared to the greatest hyperinflation of all time, which happened during the first 7 months of 1946 in Hungary.

Consider this excerpt from an article by a Bryan Taylor entitled "The Worst Hyperinflations in History: Hungary" on globalfinancialdata.com:

> Hungary was spared much of World War II's destruction until 1944 when it became a battleground between Russia and Germany, and half of Hungary's industrial capacity was destroyed and 90% was damaged. Transportation was difficult because most of the rail lines and locomotives had been destroyed. What remained had either been taken by the Nazis back to Germany or seized as reparations by the Russians.

Disclosure

Something to Think About Cont.

Prices were already rising in Hungary after the war because production capacity fell due to the destruction. With no tax base to rely upon, the Hungarian government decided to stimulate the economy by printing money. It loaned money to banks at low rates who then loaned the money to companies. The government hired workers directly, they provided loans to consumers, and they gave money to people. The government literally flooded the country with money to get the economy going again. Money may not have grown on trees, but it certainly flowed off the printing presses.

To see how quickly the money supply rose, consider the fact that the currency in circulation stood at 25 billion Pengö in July 1945, rose to 1.646 trillion by January 1946, to 65 quadrillion (million billion) Pengö by May 1946 and to 47 septillion (trillion trillion) Pengö by July 1946.

But...but….hasn't the Federal Reserve done this with all the quantitative easing and the like? Well, not as much as you might think. You have to remember, by buying bonds with money that didn't previously exist, the Fed created the potential for money creation more than the actual creation. It is just the way the mechanics work.

At the end of 2008, M2, the most widely used money supply gauge, was $8.184 trillion. At the end of 2014, it was $11.625 trillion. That is obviously a pretty huge increase of about $3.5 trillion. However, as a percent, the money supply grew at roughly a 6% annual clip. As a comparison, M2 grew at a 6.90% annualized rate from the end of 1968 to the end of 2008, a 40-year span.

Still, it seems hyperinflation is not necessarily a product of the broader definitions of the money supply, but, rather, by the amount of currency actually in circulation. You know, whether or not the government has ramped up the actual printing presses, flooding the economy with paper as it were. Well, has it?

The answer there is doesn't appear so. According to the Bloomberg, the amount of currency physically in circulation increased at a 7.1% annual rate from the end of 2008 through 2014. This, too, is also a little less than the historical average of around 7.3% from 1976-2008 (which is as far back as the Bloomberg goes). Further, it is a sight less than the 6 billion percent it grew in Weimar Germany and whatever the rate was in Hungary back in 1926.

But where in the heck did that money go? Well, it basically allowed Washington to balance its books at attractive interest rates. So, if the proof of the pudding is in the eating, the numbers 6+ years after the worst of the financial crisis suggest nothing the Fed has done will lead to an imminent collapse in the US currency.

This takes to a discussion of what happens if the world suddenly and completely loses faith in the United States, in general. Hey, who is to say it hasn't? Even so, again, what is the alternative? In fact, this potential, if you want to call it that, reminds me of a scene in one of my favorite movies, "The Outlaw Josey Wales. " In it, the Clint Eastwood character, Wales, has just, shall we say, dispatched some thugs who had ambushed a group of settlers on a wagon trail.

Grandma Sarah: This Mr. Wales is a cold-blooded killer. He's from Missouri, where they're all known to be killers of innocent men, women and children.

Lone Watie: Would you rather be riding with Comancheros, Granny?

Grandma Sarah: No, I wouldn't.

So, let me close with the following conversation I might have with a gloom & doomer:

Gloomer: This dollar is a stinker. It's from the US, where they're all known to have spent money foolishly, spent beyond their means, and printed money out of thin air to balance the books.

Me: Would you rather be holding euro, yen, pounds, pesos, rubles, or reals over the long run, dude?

Doomer: No, I wouldn't.

Hey, I am not trying to be cavalier about the situation, just realistic, Also, I don't charge for this newsletter, and I am not trying to drive people to my website or have them buy my book….possibly because I don't have either. If I did, perhaps I would go down rabbit trails to various worst case scenarios. After all, extremes, one way or the other, sell a lot better and get a lot more ink than a pragmatic MEH?