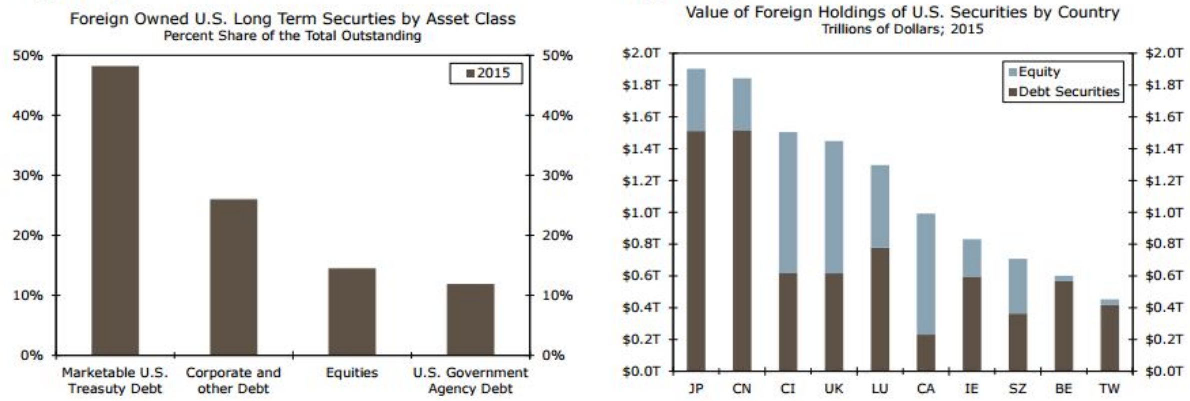
The recycling of the US dollars financing the US deficits is going to end (Part 2)

According to the latest available data, foreigners owned 48% of all Treasury debt. Although it's still high, the Wells Fargo economists note that it is down from 60% in 2008. Though following the implementation of trade tariffs it is very likely that this percentage of foreigners owning 48% of all Treasury debt will decline further because as stated before the central banks will get in less US dollars because the exports to the US will decline following the trade tariffs. This would automatically mean that the interest rates ought to rise in order to attract investors after all Americans barely save so they can't invest in Treasuries. Lately we have been witnessing rising interest rates with the 10-y Treasury yield approaching the crucial 3% level, which would signify the breakout of the 37-year range of declining interest rates. We also saw the spread between the 5y Treasury yield and the 5y Bund yield reach levels not seen since 1993. The fiscal deficit for the EU is approximately 1.25% of GDP of €15trn whilst the EU had a current account surplus of around €392bn in 2017 or 2.6% of GDP. The EU debt is approximately €12.5trn and the savings quote for the EU is about 10%. In other words with a savings quote of 10% the EU can at least finance its fiscal deficit internally not being dependent on foreign investors or monetary financing.

Another currency bloc where deficits can be financed internally is Japan. In December 2017 the household saving rate in Japan increased to 50.1% (all time high and NO mistake) from 11.90% in November of 2017. Personal Savings in Japan have averaged 11.9% from 1970 until 2017. Hence why the Japanese, as stipulated earlier, can easily finance their fiscal deficit next to that they have a surplus on their current account (balance goods and services). Though I will show later in this article that the dollar hedging costs make it more lucrative for Japanese investors to invest their money in GJBs rather than the relatively high yielding US treasuries! Imagine how high the forex hedging costs are!

Anyway in my point of view what we are witnessing is the return of risk premiums in the US treasury market for obvious reasons: financing their deficits will become much more expensive because of their very low savings rate and recently implemented trade tariffs.

Figure 3 Figure 4



Source: U.S. Department of the Treasury and Wells Fargo Securities

Wars and thus also trade wars (like the one end 20's beginning 30's) cloud deeper lying problems i.e. excessive debts, trade and budget deficits and loss of purchasing power and ultimately credibility

According to Salinas the current theme of whether "Trade War" is good for the US, misses the point entirely. The US collapse into the "Trade War" syndrome only obfuscates the real outcome: the end of the US dollar as the world's fundamental or reserve currency. If countries are unable to obtain dollars for their central bank reserves, they will have to look for a substitute of the reserve currency. And the only substitute of the reserve currency will have to be GOLD: the ultimate currency. Other currencies face the same competitive currency devaluations because they also need to compete for exports, read cheap currency.

Though I would like to state that the problem of excessive debts and budget deficits and the impossibility of meeting future obligations, especially pension obligations (in the US strongly underfunded), is not only restricted to the US. It is a problem that is plaguing the whole world including China, Japan and Europe. Next to that it should be mentioned that trade wars always happen at the end of the end of a long economic cycle.

After the great stock market crash of October 1929, lots of people were worried about jobs, and so in this case, two Republican members of Congress, Mr. Reed Smoot, and Mr. Willis Hawley, proposed massive hike in tariffs which triggered a global trade war. More than 1,000 economists signed a petition imploring President Herbert Hoover not to sign the so-called Smoot-Hawley proposal into law. Many of Hoover's top advisers and leading US businessmen also begged him not to do so. But Hoover signed it anyway June 17, 1930. Smoot and Hawley believed they were protecting American jobs by imposing tariffs on foreign imports, making them more expensive than American-made goods. But not surprisingly, the rest of the world imposed retaliatory measures, which crippled many US exporters.

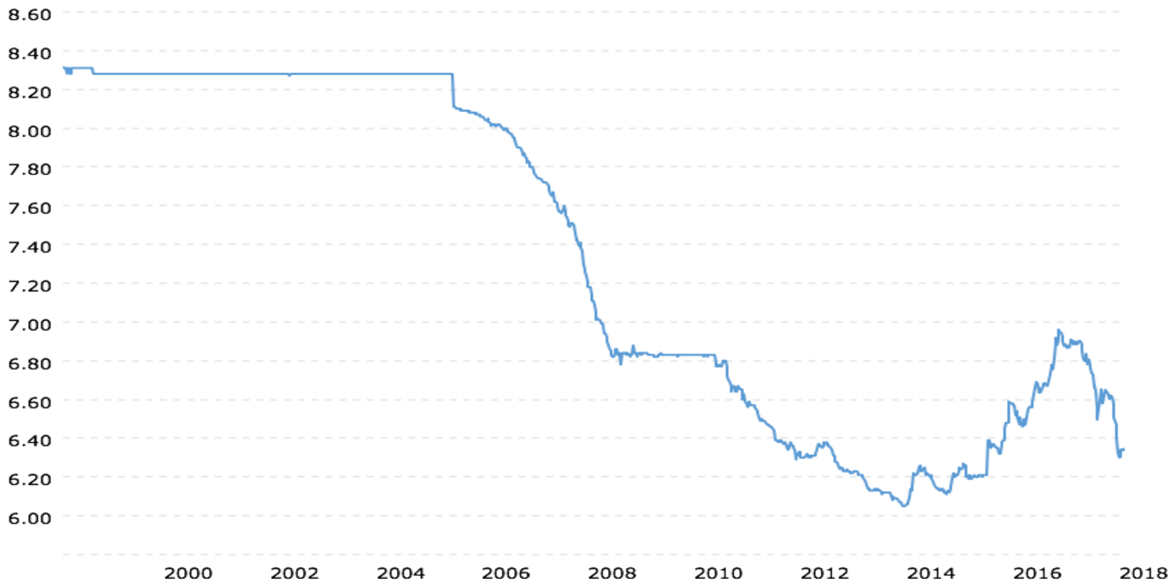
US trade with Europe and other parts of the world collapsed by two-thirds. Smoot-Hawley clearly exacerbated the Great Depression.

Anyway it is clear to me that the US has milked the system as much as it could though everything is indicating that there is a new kid on the block and that the US dollar status is under sincere pressure. Holding the 88 level for the USD index is crucial because if we break that convincingly the next stop will be 80 followed by 72 respectively a 11% and 20% fall from todays levels.

The launch of the Petro-Yuan-Gold contract planned for March 26 could be the death knell for the US dollar and setting free the gold price thereby launching gold as the anchor of the financial system

The current theme of whether "Trade War" is good for the US misses the point entirely. The US collapse into the "Trade War" syndrome only obfuscates the real outcome: the end of the US dollar as the world’s fundamental currency.

Anyway there are a lot of indications and facts that show us that the dominance of the US dollar is coming to an end and most likely to be replaced by the Yuan. On March 26 China is about to launch the Petro-Yuan-Gold contract, which they have postponed several times. The Petro-Yuan-Gold contract will enable oil producers selling oil to China to exchange Yuan into gold till the Yuan will acquire a full convertible and reserve status. See a chart of the non-convertible Yuan her below. On March 8 the USD/CNY closed at 6.3389.



Basically the Chinese are using gold to acquire their reserve status for the Yuan. Yuan pricing and clearing of crude oil futures is the "beginning" of a broader strategic push "to support Yuan pricing and clearing in commodities futures trading," Pan Gongsheng, director of the State Administration of Foreign Exchange, said last month. To support the new benchmark, China has opened more than 6,000 trading accounts for the crude futures contract, Reuters reported in July 2017.

The recent gold shipments from China to London show us that there no physical gold available in order to meet demand in relation to the to be launched Petro-Yuan-Gold contract

The London market, which is the market for the physical delivery in the West, is in backwardation for 13 weeks because there is not enough physical gold for delivery available! The Shanghai Gold Exchange is the only 100% backed gold and silver market in the world. The other markets are all fractional (read not physically backed) markets and thus illusionary or fake markets because the price setting is purely based on buying and selling paper futures contracts.

The reason for keeping these markets fractional (not backed by the physical) is that the price of gold can be controlled/depressed so that the US dollar can shine and keep the illusionary idea going that the US dollar still has value. I can't emphasize enough that gold is the mirror image of the reserve currency, the US dollar, because gold is expressed in US dollars and because gold is the ultimate currency as physical gold is nobody's obligation contrary to fiat currencies that represent an obligation of the monetary and political authorities of a country to maintain the purchasing power, the value of the currency. In other words lower the gold price and the US dollar "is valued higher" and the other way around.

The Comex sets the gold price through the use of naked or fractional futures (no back up in terms of physical/registered inventories) whilst for physical delivery the counterparts (bullion banks) need to enact a so-called EFP or Exchange Futures for Physical swap through the London LBMA market, an OTC market or market between 2 parties and thus not in the public domain hence no price discovery (contrary to a price discovery of a multi-party Comex exchange market where prices are in the public domain and thus result in price discovery!!).

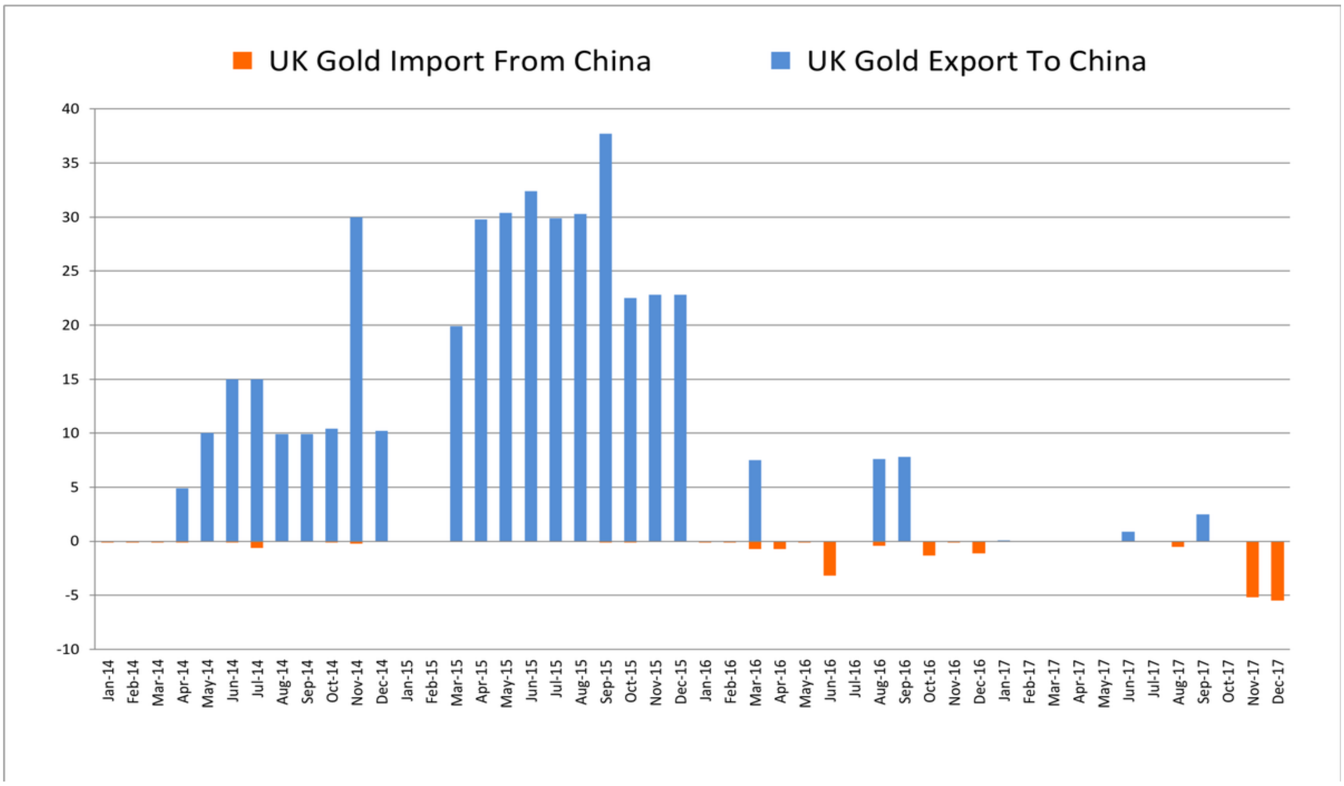
I want to emphasize that **THE PRICE SETTING FOR THE GOLD PRICE IS THE COMEX AND NOT THE LONDON LBMA!** If the Comex would be backed 100% by gold inventories the bullion banks couldn't pull off their game of managing the gold price through shorting or dumping naked (no physical backing) gold futures contracts. Because there is not enough physical gold available to back these contracts with some 27m oz. or 840 tons (200,000 tons on an annual basis) of physical gold traded on the Comex every day (equal to 27% (840/3,100) of yearly global gold mine production of 3,100 tons). Hence why the bullion banks and Fed and BIS have a strong interest in keeping the Comex a fractional market and not backing it up with physical gold in the registered inventories, the inventories allocated or available for delivery on futures contracts.

The gold futures open interest is roughly 500,000 contracts which is equal to 50m oz. (100oz per futures contract) whilst the Comex registered gold warehouse holds only 339,000 oz., which thus translates in a paper/physical ratio of 147x in other words there are 147 paper gold ounces for one physical gold ounce in registered inventories. Ask yourself what will happen to the gold price when those holders of 147 paper ounce contracts all want delivery of that one physical ounce of registered gold. I should state of course that part of these paper holders are most likely also the bullion banks though you get the gist what will happen when the US dollar loses its value and thus everybody wants that physical ounce of gold and not the devaluing US dollar. And remember it is always about the rate of change!

The EFP swap is done firstly to avoid the default of the Comex, which it technically is, and secondly as mentioned to avoid people having insight in the tightness in the physical gold market because an agreement between two parties is not publicized. Next to that the LBMA participants in London trade 1.5 million tons of paper claims in the unallocated gold pools in London annually (equal to 500x the annual gold mine production!). This is done in my point of view in order to diminish the importance of the physical gold price discovery and to keep the gold price within the targeted gold prices 'set' by the bullion banks. If the claim trading sets a gold price through the two daily London fix of say

$1350/oz. it will probably be difficult for buyers of physical gold to get a much higher premium if they want to get a premium for their EFP contract even if the gold market is in backwardation (spot price higher than futures price) indicating a tight physical gold market. These bullion banks try to mislead through obscurity.

Anyway the reason I am summarizing this is because the Chinese are apparently exporting gold to London (see chart below) whilst the Chinese have very strict rules that gold is not allowed to leave the country.



In my point of view the reasons why the Chinese export gold to London is either because:

1. The Chinese want to purchase gold at as low prices as possible for as long as possible, so that they can purchase gold cheaply and because they don't want the volatility because it would affect the volatility and thus credibility of the Yuan as a reserve currency.
2. The Chinese want to be able to deliver the counterparts of the Petro-Yuan-Gold contracts (going life on March 26) with the physical gold going into their vault holdings in London (the Saudis have a strong London presence) because the London LBMA/BB vaults don't have enough physical gold to meet the demand (13 week backwardation) that could stem from the new contract and as a result the Petro-Yuan-Gold contact

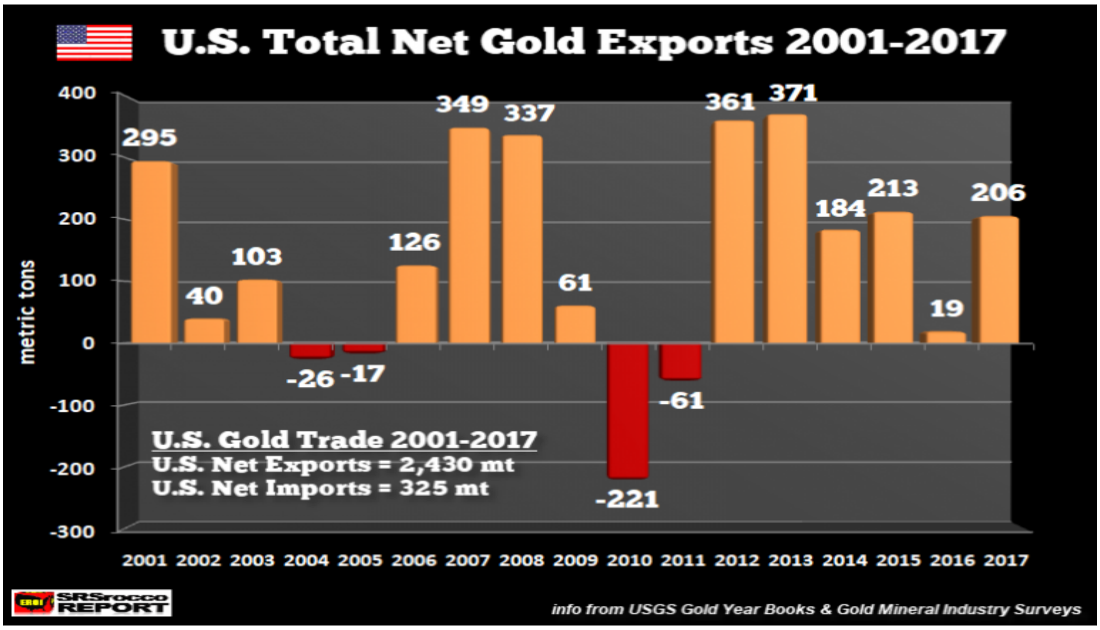
would fail which would be a blamage for the Chinese and severely tarnish their credibility on their road to Yuan convertibility.

And thus the more interesting it will be to see what will happen in the run up to March 26 in terms of EFPs and the gold price development.

The Amazing Amount of Gold The U.S. Exported Since 2000

I used this information from SRS Rocco report because ultimately the amount of gold held in the forex reserves will prevent a currency from an implosion if the there is a debt crisis. Hence why the dire straits the Italian economy is in might be less desperate than one thinks because the Italians are officially believed to have 2,451 tons of gold, officially worlds third largest holder of gold reserves.

The U.S. has been exporting an astonishing amount of gold since the turn of the century. And as the price of gold surged along with the massive increase in U.S. debt, gold exports jumped to record highs. The U.S. exported nearly 8,000 tons of gold since 2001 though it also imported a great deal as well. Thus, we arrive at a "net export" of a staggering 2,340 (2,665-325) tons of gold that were shipped abroad. Apparently U.S. gold net exports picked up during the 2007-2008 collapse most likely to serve as collateral to rescue certain financial institutions that were under water. According to some insiders during 2008/2009 the Fed used $16trn to prop up several financial institutions all around the world in order to prevent the global financial system from collapsing and thus also the US economy which could otherwise have threatened the reserve status of the US dollar and thus its military power.



Officially the US gold reserves amount to 8,133 tons and as far I am aware I haven't seen any officially report changing this figure. In the context of the net exports we should also look at the United States own gold mine production, which has amounted to between 210-225 tons annually of which domestic demand consumes a large percentage. The Chinese are the number 1 world gold producer producing 463.7 tons in 2016 and approximately 422 tons in 2017. The second largest gold producer is Australia with an annual production of roughly 270 tons.

Apparently the majority of U.S. gold exports were shipped to Switzerland (refineries), the U.K. (LBMA vaults), and Hong Kong (imports into China). And these three countries received more than 80% of U.S. gold exports during the 17-year period. What has puzzled me for many years is that the USA thinks that the US dollar will keep its reserve status forever and that therefore gold, the ultimate currency, has lost it ultimate reserve status. The suppression of the gold price has basically played into the hands of especially China and Russia that as a result of the suppression have been able to purchase gold, the only currency which value is not dependent on the obligation of a counter-party, on the cheap.

When the U.S. Dollar finally loses its world reserve status, signified by a strong loss in value and credibility, we will see who is wearing swim trunks (and have the gold inventories they state they have) when the water recedes.

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NB: Correction re Part !, I meant of course that the Chinese are interested to buy 5% in Aramco.