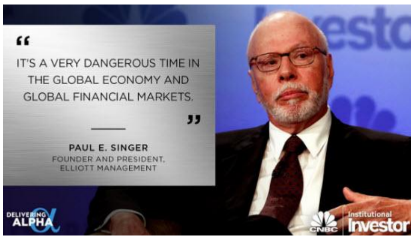
By Julian D.W. Phillips 19th September 2016

This article takes from previous articles featured in the *Gold Forecaster* weekly issues

Dangerous Times for stocks - U.S. is headed toward stagflation - We're not in a stable equilibrium. It's a good time for Gold and Silver!



Most global financial markets struggling to rise, central bank policies are placing interest rates at all time lows. These are not producing the results wanted [but are holding deflation at bay].

Important governments are emasculated by political stalemate, while the structure of the E.U. is facing what Junker calls an 'existential problem' [translated is under threat from an array of problems].

Hence, the comments by Alan Greenspan, Paul Singer and several others demand our attention.

In this article, we will try to look forward to the world they are looking at which is thundering on its way towards us.

The title of this article are a series of quotes are from Paul Singer and Alan Greenspan, two successful and respected men with a long history in the financial world. Well, you already knew that. But the significance of their remarks, at a time when investors and funds are almost forced to keep a myopic view of the financial world, is important, as these come from experts standing back and giving a more distant perspective, almost uncluttered by short term financial incidents.

The Long view from Greenspan & King

Singer and Greenspan are not alone for Mervyn King, in the 'End of Alchemy', the former head of the Bank of England, writes of central banks' frustration in dealing with the stagnant global economy. "Central banks," he says, "have thrown everything at their economies, and yet the results have been disappointing, "Whatever can be said about the world recovery since the crisis, it has been neither strong, nor sustainable, nor balanced."

Former IMF chief economist, Olivier Blanchard was recently quoted as saying: "And so the question is why is it, that with no fiscal consolidation and banks in decent shape, at least in terms of lending, and zero interest rates, we don't have an enormous demand boom? That is now the puzzle."

Greenspan expanded on his comments further, saying, “"**This is the worst period, I recall since I've been in public service. There's nothing like it, including the crisis —** remember October 19th, 1987, when the Dow went down by a record amount 23%? That I thought was the bottom of all potential problems. This has a corrosive effect that will not go away. I'd love to find something positive to say**.**"

Greenspan was referring to the unprecedented combination of economic stagnation, deteriorating demographics, insolvent entitlement programs, social inequity and wealth division, and of course, a historic debt overhang which could and should have been cleared out in the crash of 2008

He then repeated a point that has been widely accepted in recent months, namely that monetary policy - while still the only game in town - is now impotent. Greenspan said the ECB is limited in what it can do because these fundamental problems like the stagnation of real incomes don't have easy solutions. "**There's a certain amount that monetary policy can do, but our problem is fundamentally fiscal,"** he said, adding that this is true in the United States as well as "every major country in Europe." Part of the problem is that the "developed countries are all aging very rapidly," which is leading to a higher ratio of government spending in the form of entitlements.

A far bigger part of the problem is the toxic loop of monetary and fiscal policy which we have pounded the table on for years, and which S&P laid out for all to see when it said that the more monetary easing takes place, the less incentive there is for reform and actual fiscal policy.”

Consequences

And yet financial markets the world over are apparently relatively stable. But most professional would not argue with the above comments but are seriously worried at the prospects that lie ahead.

The oft told story, of the man who fell off the 50-story building, that was heard to say, as he passed the twelfth floor, “So far so good!” appears to apply to our financial world now.

The “Credit Crunch” was the start of the set of consequences that still have to play out to the end. Yes, we can comfort ourselves that the U.S. economy is solid and not in recession, the E.U. is not in recession but is in crisis that has yet to mature. Quantitative Easing looked good and has given the U.S. a respite against structural collapse, but the jury is out on Japan and the E.U. The world outside the U.S. is capable of dragging the U.S. down, initially through a strong dollar.

Most believe that the dangers described by these august men can be reversed and all will be well. After all, we have a President Trump on the way, who is going to “make America great again”. But the realities tell us a different story.

Stagflation

Greenspan forecasts “Stagflation”. We have been forecasting for years the likelihood of stagflation but, through central bank actions, essentially fighting deflation, this has not happened, yet. But now, this huge super-tanker of the developed world economies is soon to complete its full turn, started in 2008. But now the time is almost here.

If we look back to the **Weimar Republic** to see what the ingredients were that precipitated the hyperinflation, we see a nation that could not grow sufficiently and fell back from stagnation to shrinkage.
Inflation, which was encouraged by the government to enable it to pay reparations, took off. With a shrinking economy the money supply was growing, proving excessive for the smaller economy. This accelerated the inflation that was taking off by itself. It is this combination of inflation in a shrinking

economy. The U.S. is not there, yet, but if it does start to shrink inflation will certainly take off and will not be attended by growth.

What is there that is a common denominator today? Stagflation, after central bank efforts to invigorate economies, without significant government backing, is, as Greenspan says, almost inevitable. Central banks have run out of effective weapons to fight it.

On top that central banks and nations, sit with vast, unprecedented debt. It is clear that nations, so long as they have power, will do anything to prevent defaults, even though, as in the Weimar republic, inflation made debt easily repayable. Nations are different insofar as if they lost their financial credibility, internationally, they need gold survive financially. Venezuela is there now. Weak southern members states in the E.U. were there in the Sovereign debt crisis and used gold/currency swaps maintain credibility. No nation can be financially profligate without consequences.

If no further stimulus is given to the developed world, we believe that deflation will accelerate. This requires greater stimulus in greater amounts to ensure inflation takes off. The danger is that if 'stagflation' degenerates into shrinking recession or worse, inflation will not prove controllable. When Volker used huge interest hikes to match inflation in the eighties it was on the back of a healthy economy in a very different world. At some point in the future, [likely to be closer than you think] such inflation will be excessive. But with economic stagnation, any attempt to halt it could produce economic failure. This is not an option without robust growth [unlikely].

Because we live in an interconnected world and monetary system, the credibility of and confidence in currencies will be flailed. The need for a stable anchor for currencies will be inescapable!

The Chinese Empire

Add to this that China is constructing itself as an independent empire. The economic growth in China has been at the expense of the developed world. In 2000 80% of global cash flow went to the developed world. By 2020 only 35% will go to the developed world and 65% to the emerging world. At the moment the developed world gets around 55% of the global cash flow, but this is falling. <u>This is the foundation of the economic decay of the developed world</u>.

To us the key points that we see that will affect the future in the short, medium and long-term are:

1) The persistent issuance of new money across the developed world and China. Add to this Greenspan's concerns of social welfare obligations on both sides of the Atlantic may well prove to be a burden too many for governments in the near future.

2) The ongoing attempts to lower exchange rates in a race to achieve international competitiveness which will simply result in the international loss of credibility of the world's currencies.

3) The excessive increase in national & other debt that will weigh heavily on rising debt: GDP ratios, against a backdrop of continuous and likely rising deflation. This becomes obvious when one sees that despite the vast sums of money that have been created there has barely been any impact on global inflation.

4) A growing expectation of protectionism [the heavy tariff now being levied on Chinese steel in the U.S. is a start of this process] on both sides of the Atlantic. As currency confidence wanes between nations and exchange rate volatility grows, we expect an increase in defensive actions eliminating trade advantages of other nations.

5) In addition, we expect Capital Controls to be imposed where either the inflow of capital into strong currencies becomes excessive or the outflow from weaker countries threatens a collapse of the currency.

6) We see growing division between east and west and between nations in the developed world. Brexit, the decay in the Eurozone, the TTIP trade deal breakdown are all symptomatic of what lies ahead.

7) It will be divided and that division will highlight its weaknesses. These will exert destructive pressures which will reflect in the confidence in currencies. The net result over time is that what Greenspan, King and Singer said points to a qualitative breakdown of currencies and the global monetary system. The response of nations will be defensive exacerbating the global troubles.

8) This is when gold, an important reserve asset [as confirmed by the Central Bank Gold agreements since 1999] will be put back in the position it was when paper currencies departed from gold as their anchor.

Put in the words of Greenspan & Singer, "These are dangerous times for stocks" "The U.S. is headed towards stagflation - We're not in a stable equilibrium." – Both men favour gold as the investment!