Towards a new monetary order – and the role of gold

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A bit of monetary history

Phase I:	1816 – 1914, The *classical gold standard*
Phase II:	World War I and shortly thereafter
Phase III:	1926 – 1931, The *gold-exchange standard*
Phase IV:	1931 – 1945, fluctuating fiat currencies
Phase V:	1945 – 1968, the *System of Bretton Woods*
Phase VI:	1968 – 1971, the demise of the System of Bretton Woods
Phase VII:	As from August 1971, fiat money system

"The abandonment of the gold standard made it possible for the welfare statists to use the banking system as a means to an unlimited expansion of credit. They have created paper reserves in the form of government bonds which — through a complex series of steps — the banks accept in place of tangible assets and treat as if they were an actual deposit, i.e., as the equivalent of what was formerly a deposit of gold. The holder of a government bond or of a bank deposit created by paper reserves believes that he has a valid claim on a real asset. But the fact is that there are now more claims outstanding than real assets."

(...)

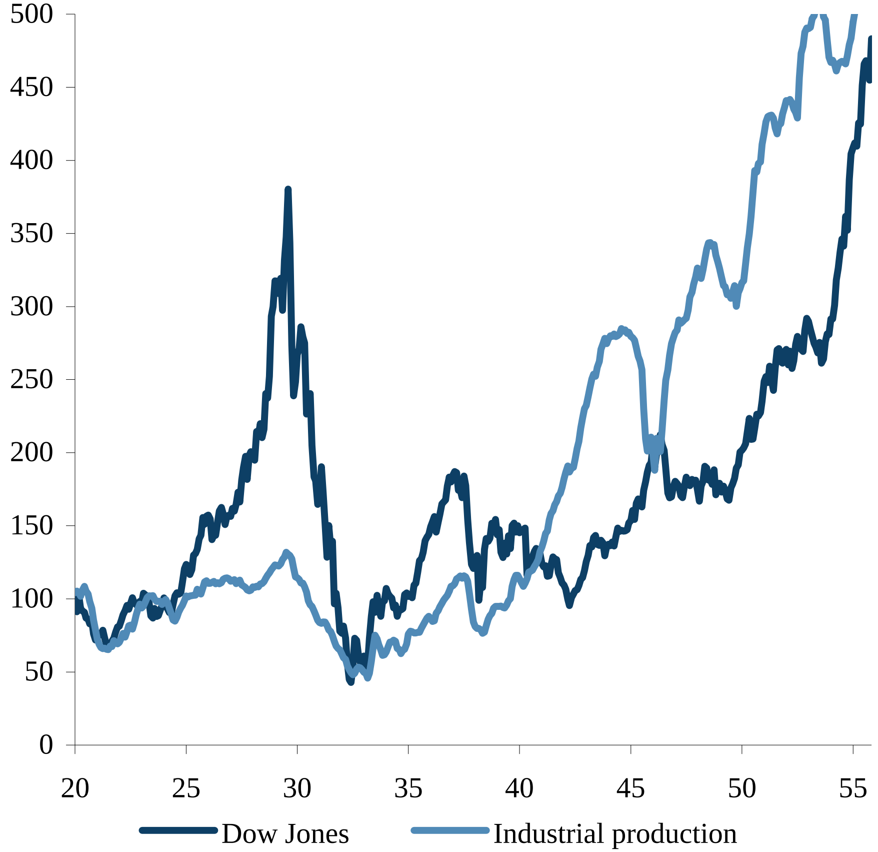
"In the absence of the gold standard, there is no way to protect savings from confiscation through inflation. There is no safe store of value. (...) The financial policy of the welfare state requires that there be no way for the owners of wealth to protect themselves."

(...)

"This is the shabby secret of the welfare statists' tirades against gold. Deficit spending is simply a scheme for the confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statists' antagonism toward the gold standard."

Source: Alan Greenspan, "Gold and Economic Freedom," published in Ayn Rand's "Objectivist" newsletter in 1966, reprinted in her book, Capitalism: The Unknown Ideal, in 1967.

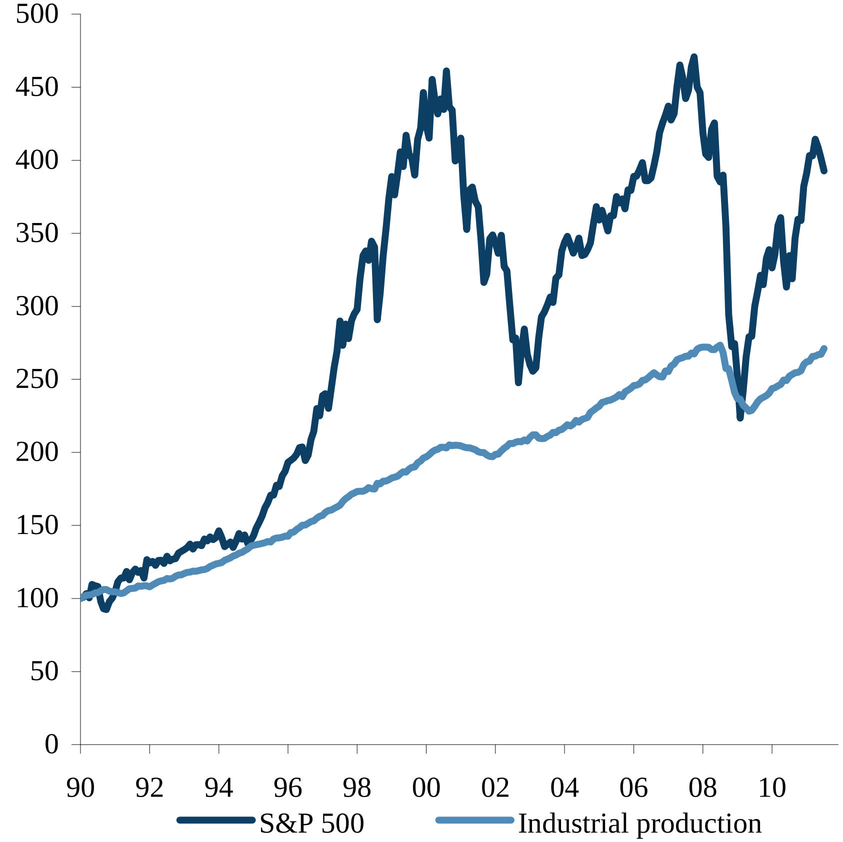
US in 1920 to 1955*



Source: Bloomberg, Federal Reserve Bank of St. Louis.

*Industrial production (nominal) indexed (Jan '20 = 104.21)

US 1990 to 2011*

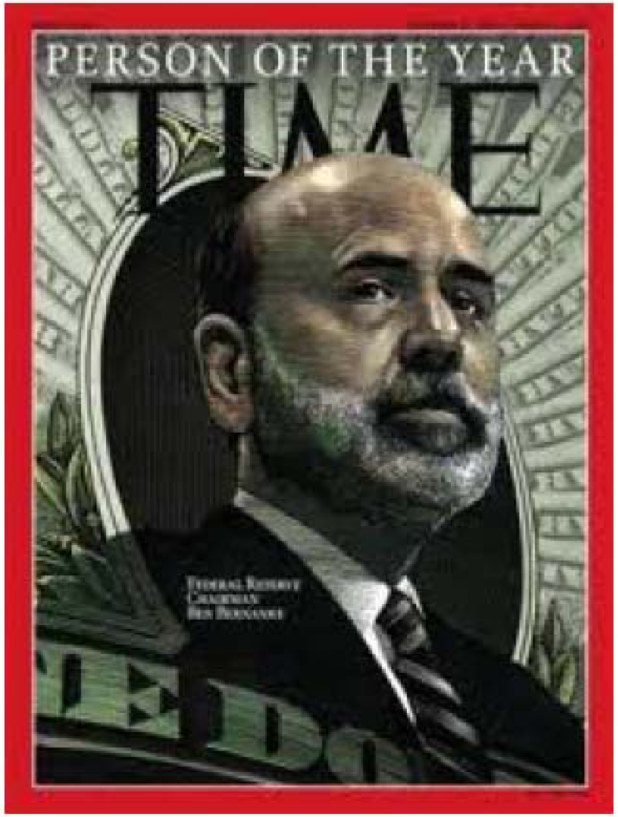


Source: Bloomberg.

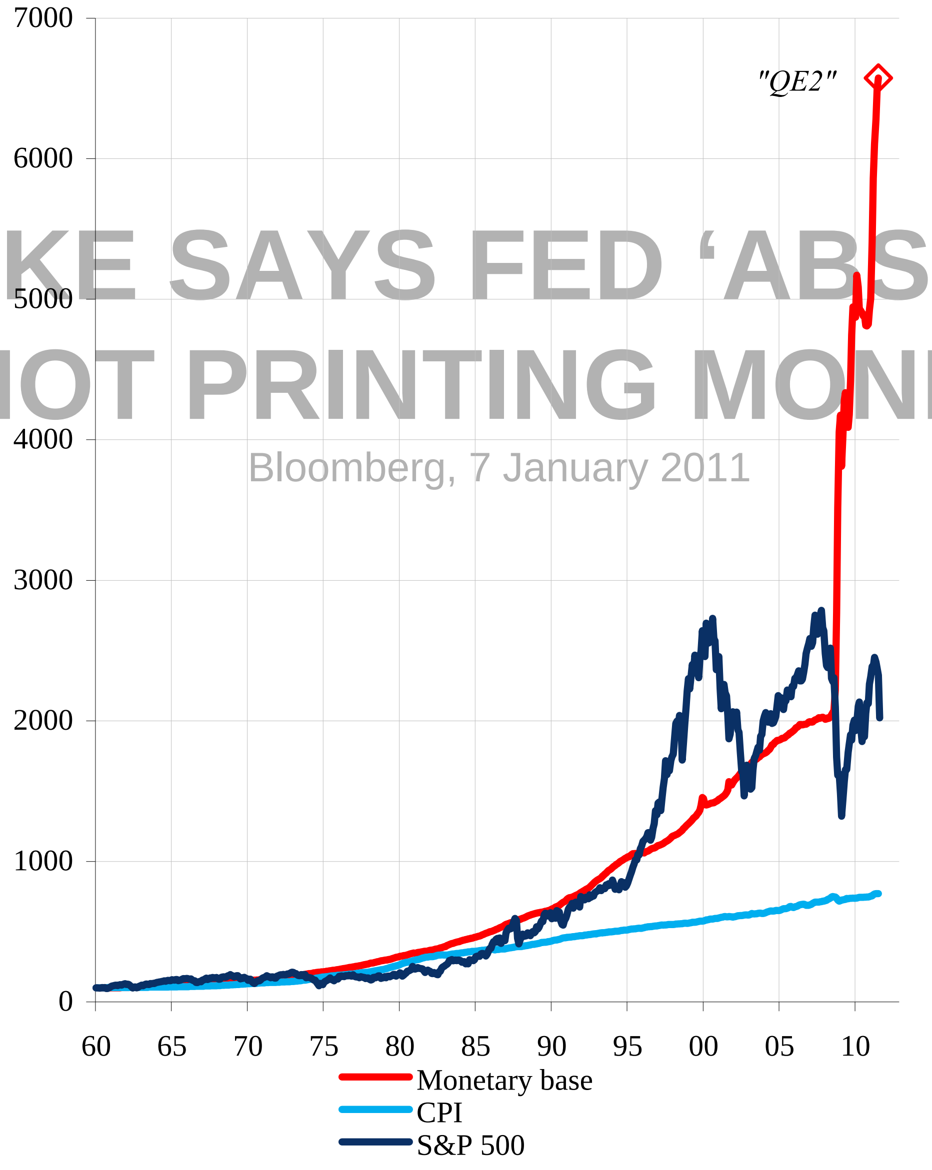
*Series indexed (Jan '90 = 100). Industrial production nominal.

„Like gold, U.S. dollars have value only to the extent that they are strictly limited in supply. But the U.S. government has a technology, called a printing press (or, today, its electronic equivalent), that allows it to produce as many U.S. dollars as it wishes at essentially no cost. By increasing the number of U.S. dollars in circulation, or even by credibly threatening to do so, the U.S. government can also reduce the value of a dollar in terms of goods and services, which is equivalent to raising the prices in dollars of those goods and services. We conclude that, under a paper-money system, a determined government can always generate higher spending and hence positive inflation."

Bernanke, B. S. (2002), Deflation: Making Sure „It" Doesn't Happen Here, Before the National Economists Club, Washington, D.C. November 21.



US monetary base, CPI and S&P 500

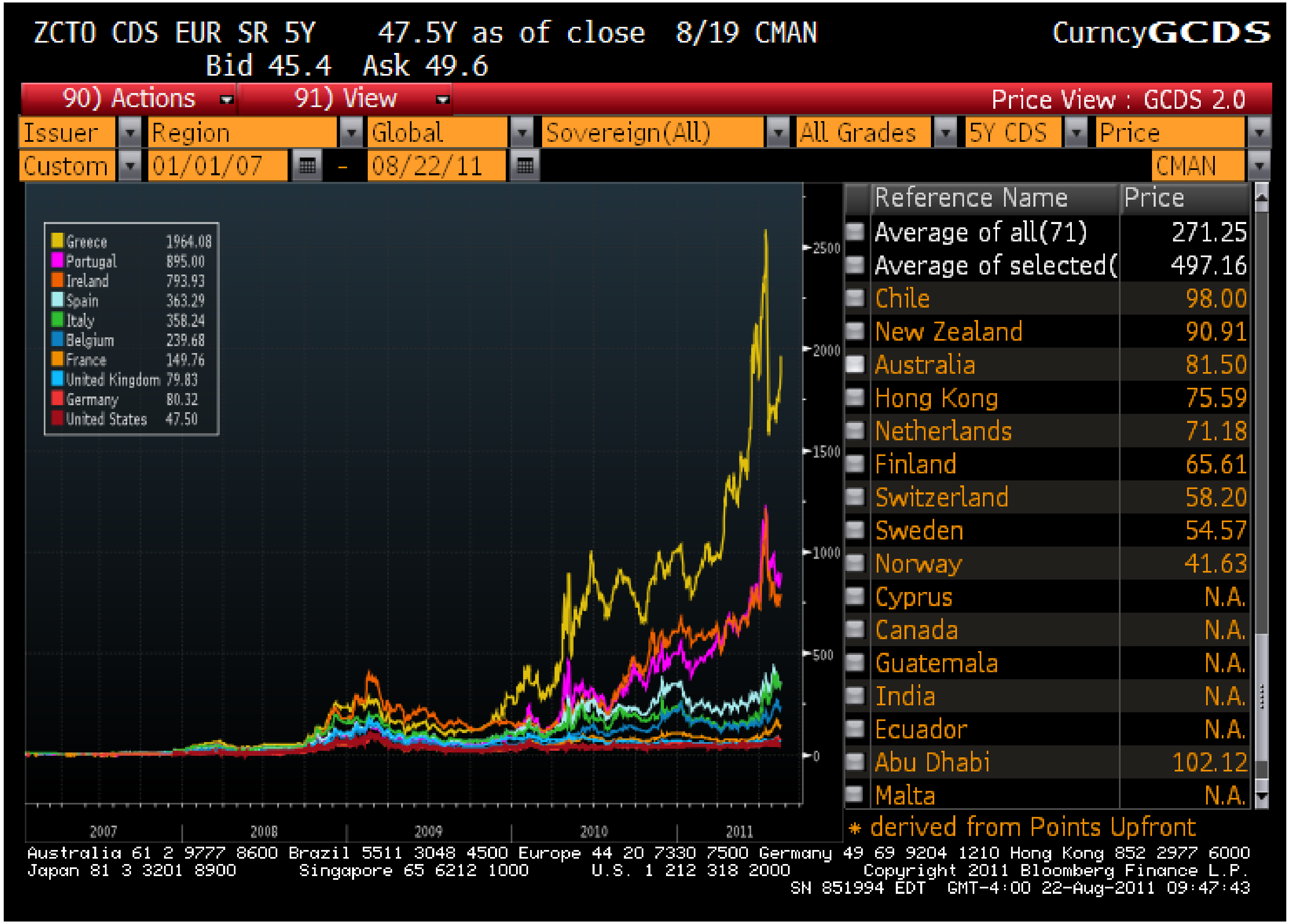


BERNANKE SAYS FED 'ABSOLUTELY' NOT PRINTING MONEY

Bloomberg, 7 January 2011

Source: Thomson Financial, own calculation.

*Series are indexed (Jan '60 = 100).


ZCTO CDS EUR SR 5Y 47.5Y as of close 8/19 CMAN
Bid 45.4 Ask 49.6
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90) Actions
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CMAN
Greece 1964.08
Portugal 895.00
Ireland 793.93
Spain 363.29
Italy 358.24
Belgium 239.68
France 149.76
United Kingdom 79.83
Germany 80.32
United States 47.50
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Average of selected(497.16
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New Zealand 90.91
Australia 81.50
Hong Kong 75.59
Netherlands 71.18
Finland 65.61
Switzerland 58.20
Sweden 54.57
Norway 41.63
Cyprus N.A.
Canada N.A.
Guatemala N.A.
India N.A.
Ecuador N.A.
Abu Dhabi 102.12
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"The global crisis resurrected deep-rooted concerns about the functioning of the international monetary system (IMS). Despite its relative stability, the current "non-system" has the inherent weaknesses of a setup with a dominant country-issued reserve currency, wherein the reserve issuer runs fiscal and external deficits to meet growing world demand for reserve assets and where there is no ready mechanism forcing surplus or reserve-issuing countries to adjust."

—KDI/IMF Conference on Reconstructing the World Economy, February 25, 2010, Seoul, Korea, *http://www.imf.org/external/np/seminars/eng/2010/kdi/pdf/ims.pdf*

Conference of Bretton Woods, July 1944

"The system should also consider employing gold as an international reference point of market expectations about inflation, deflation and future currency values."

Source: Zoellick, R., The G20 must look beyond Bretton Woods II, in: FT, 7 November 2010.

“The desirable goal of reforming the international monetary system … is to create an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies.”

Source: Zhou Xiaochuan, Governor of The Peoples’ Bank of China, Reform the International Monetary System, 23 March 2009.

Milton Friedman
1912 – 2006

"(…) a world monetary system has emerged that has no historical precedent: a system in which every major currency in the world is … on an irredeemable paper money standard (…).

"The ultimate consequences of this development are shrouded in uncertainty."

Friedman, M. (1992), Money Mischief: Episodes in Monetary History, Harcourt Brace Jovanovich, New York, 1992, pp. 249, 252 – 4.

Friedrich August von Hayek
1899 – 1992

“The past instability of the market economy is the consequence of the exclusion of the most important regulator of the market mechanism, money, from itself being regulated by the market process.”

Hayek, F. A. v. (1976), Denationalisation of Money, The Institute of Economic Affairs, London, p. 102.

Ludwig von Mises
1881 – 1973

„The wavelike movement affecting the economic system, the recurrence of periods of boom which are followed by periods of depression, is the unavoidable outcome of the attempts, repeated again and again, to lower the gross market rate of interest by means of credit expansion. There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.“

Ludwig von Mises (1996), Human Action, 4th edition, p. 572.

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Carl Menger
1840 – 1921

Money is the universally accepted means of exchange.

→ *The exchange function of money is the sole function of money. The store of value function, the unit of account function and the deferred payment function are subfunctions of the means of exchange function of money.*

Money must have emerged spontaneously from barter.

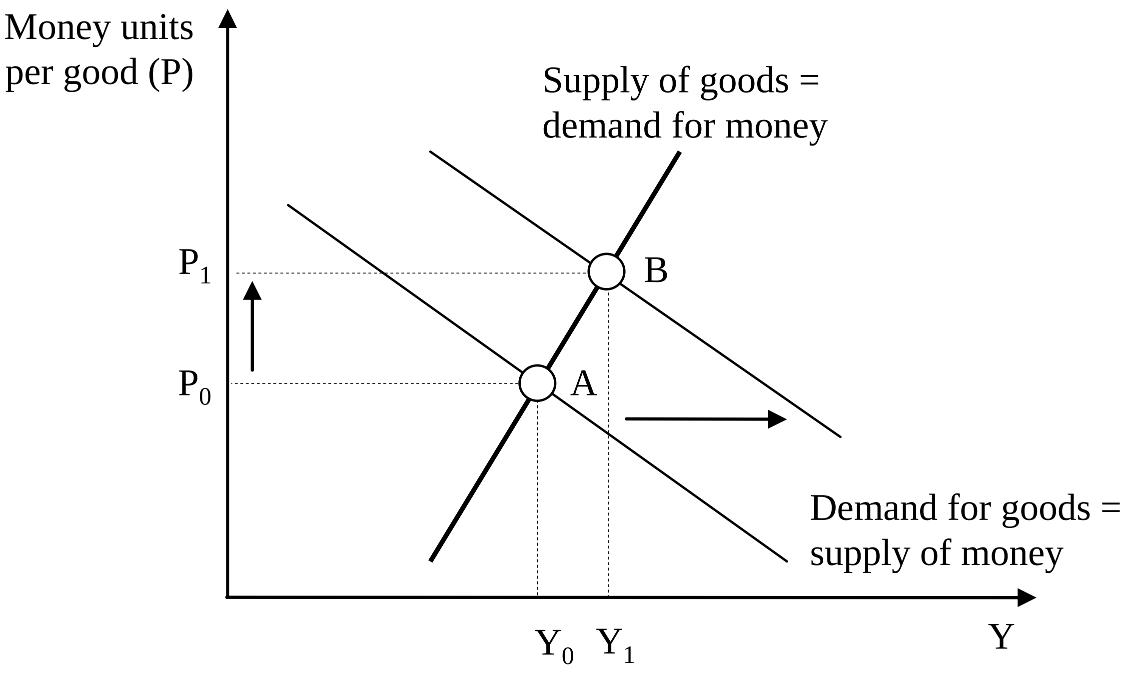
Why do people hold money?

→ *Uncertainty and the purchasing power of money*

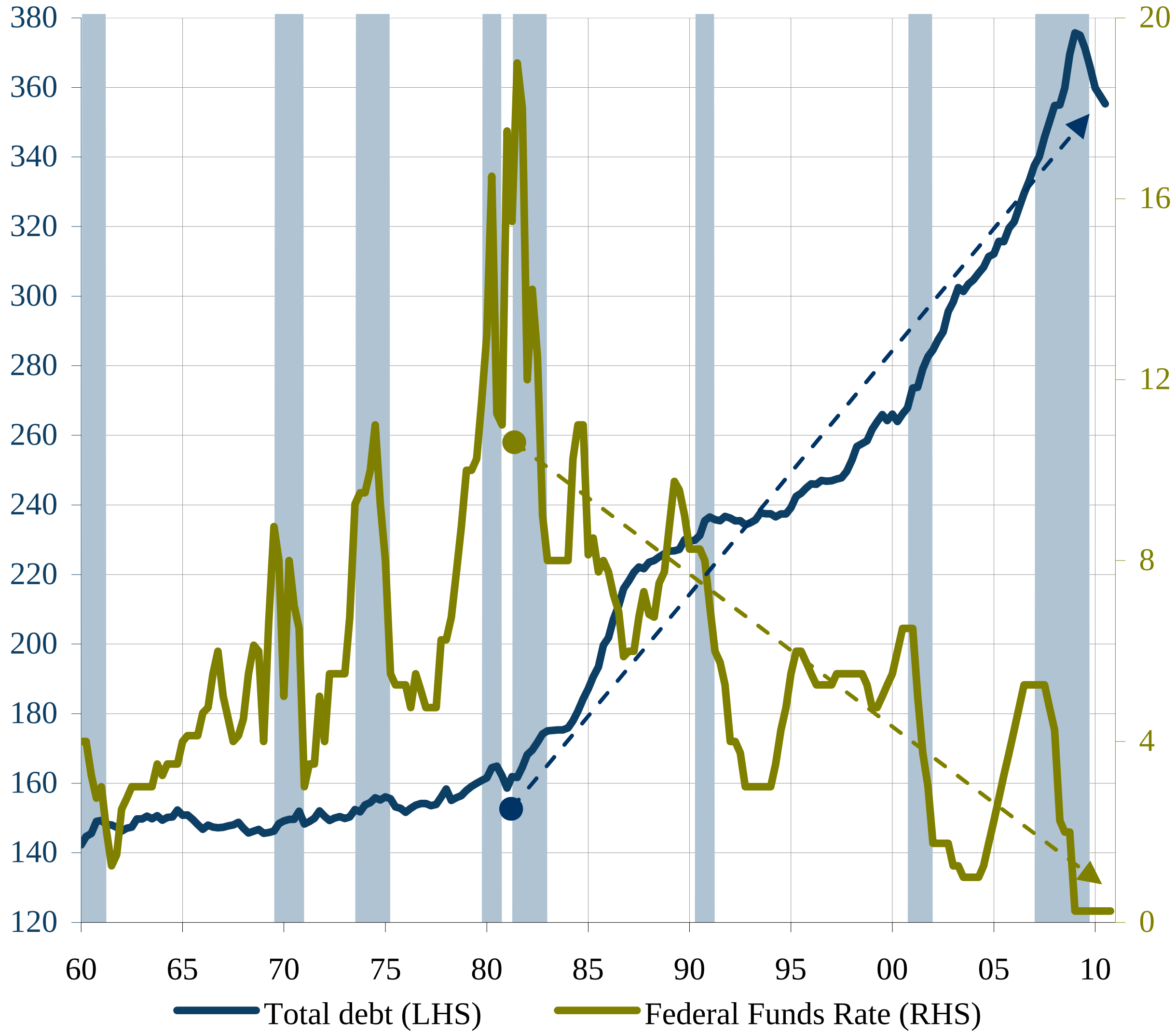
- The purchasing power of money is the number of goods that can be exchanged against a money unit.

- In a monetary economy, the *purchasing power of money* is determined by the supply of and demand for money.

The Purchasing Power of Money

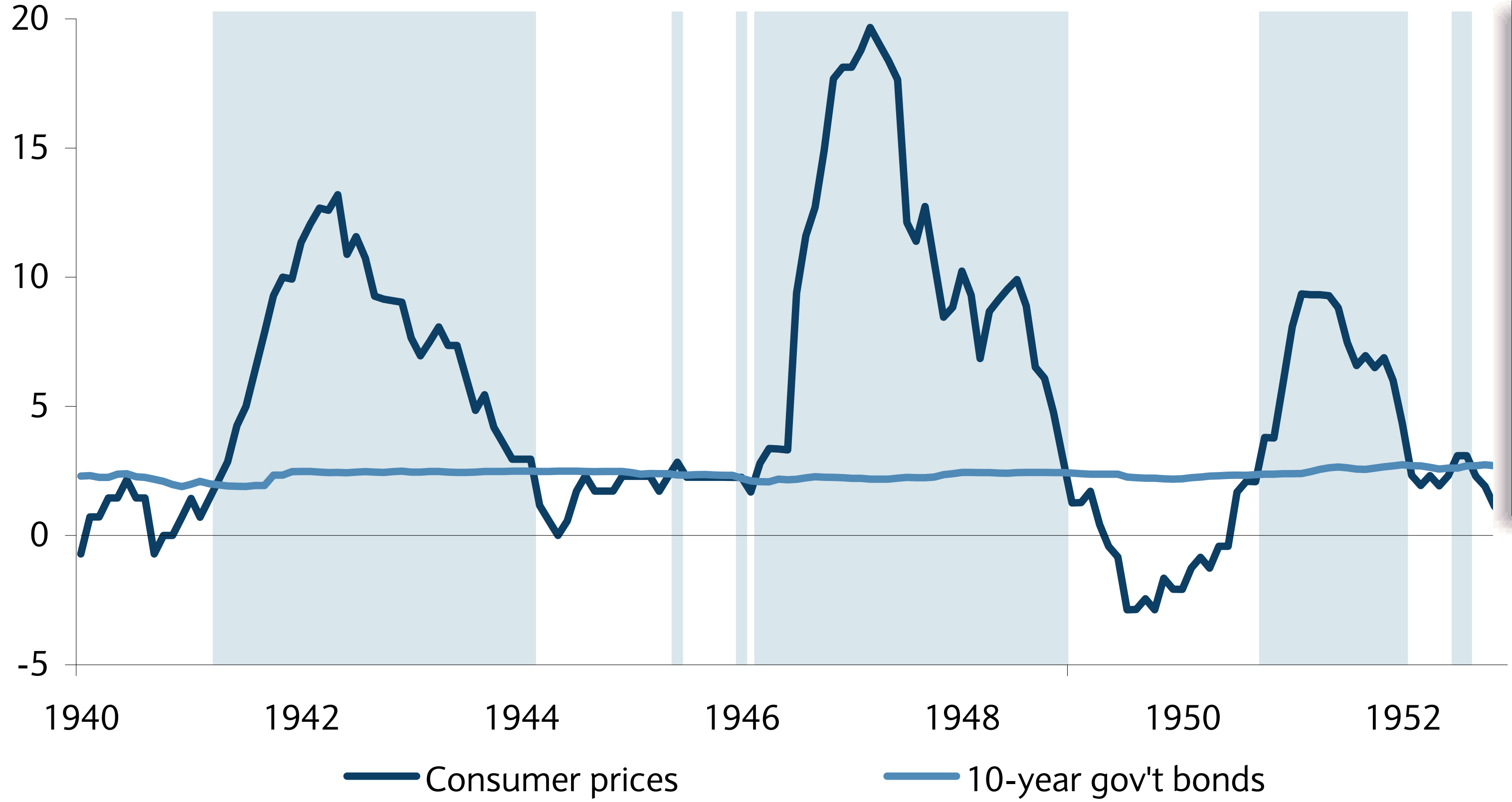


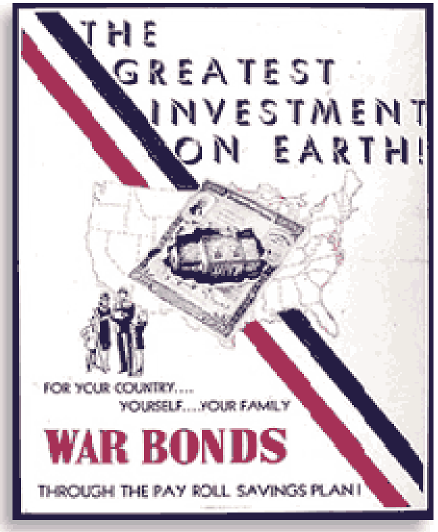
US total debt level in % of GDP and Federal Funds Rate (%)



Source : Thomson Financial, own calculations. Shaded areas represent recession periods according to NBER. Effective Federal Funds Rate up to 1971-Q1, thereafter target rate.

US consumer prices (% y/y) and 10-year gov't bond yields (%), 1940 - 1952

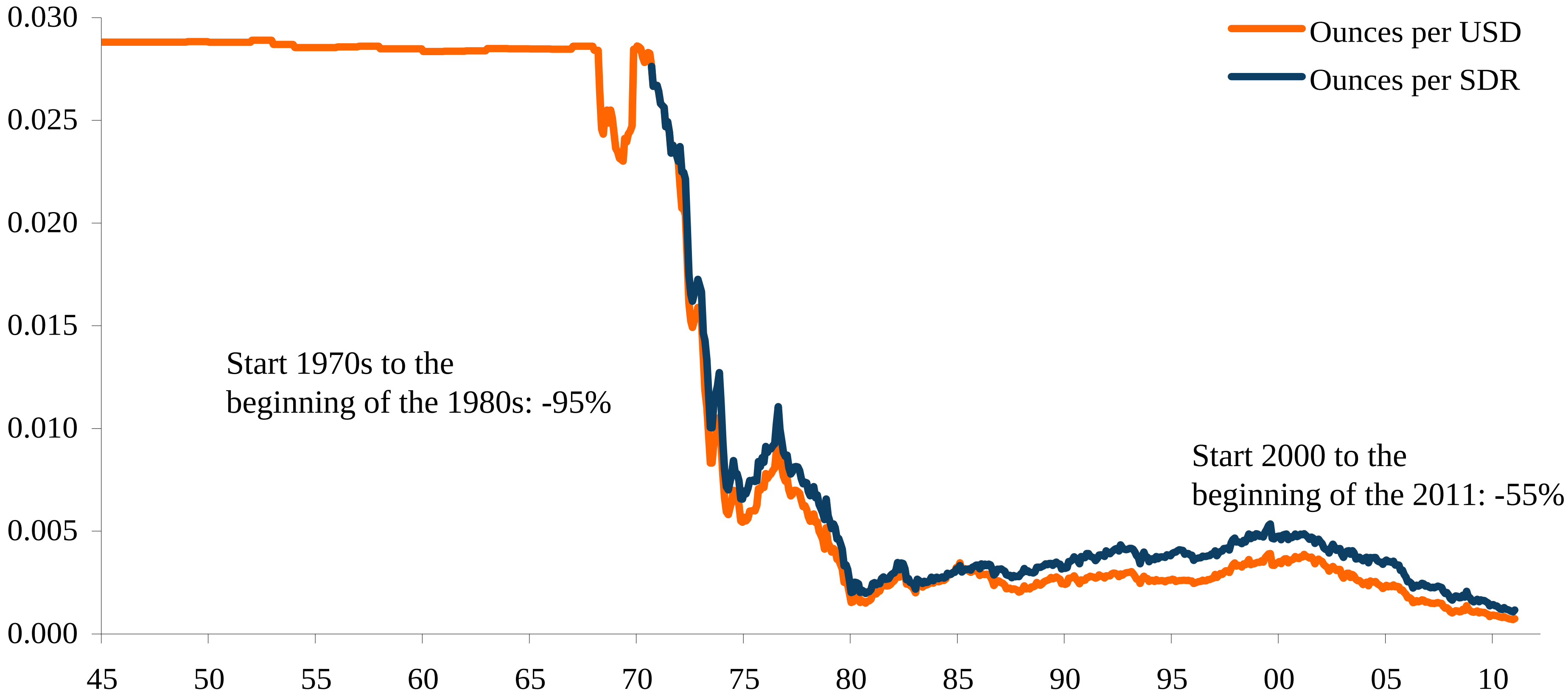




World War II War Bonds poster

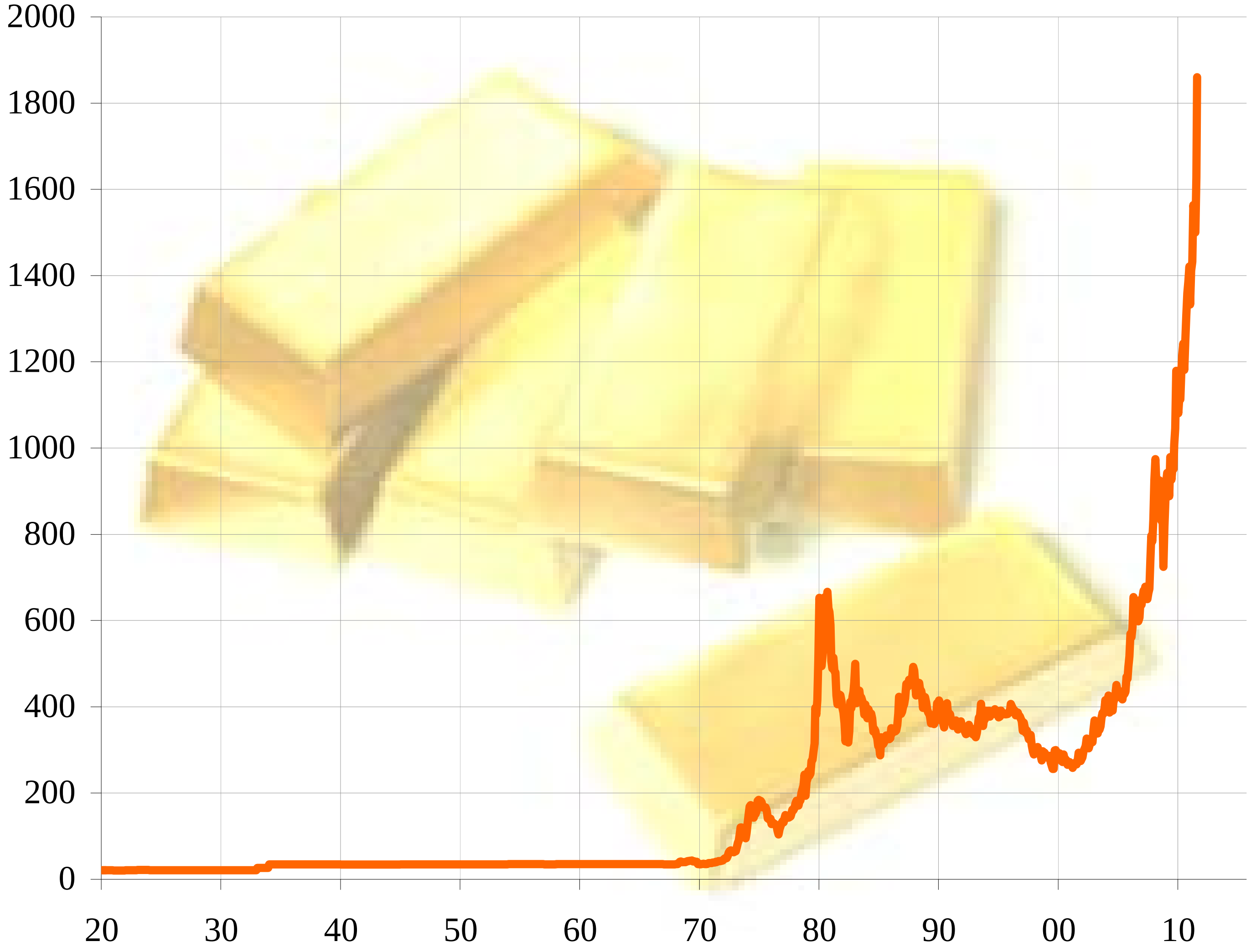
Source: Federal Reserve Bank of St. Louis, R. Shiller, own calculations.
Shaded areas: Consumer price inflation higher than nominal yields.

Gold ounces per USD and Special drawing rights (SDR)



Source: Bloomberg, own calculation.

US$ per ounce of gold



Source: Bloomberg.

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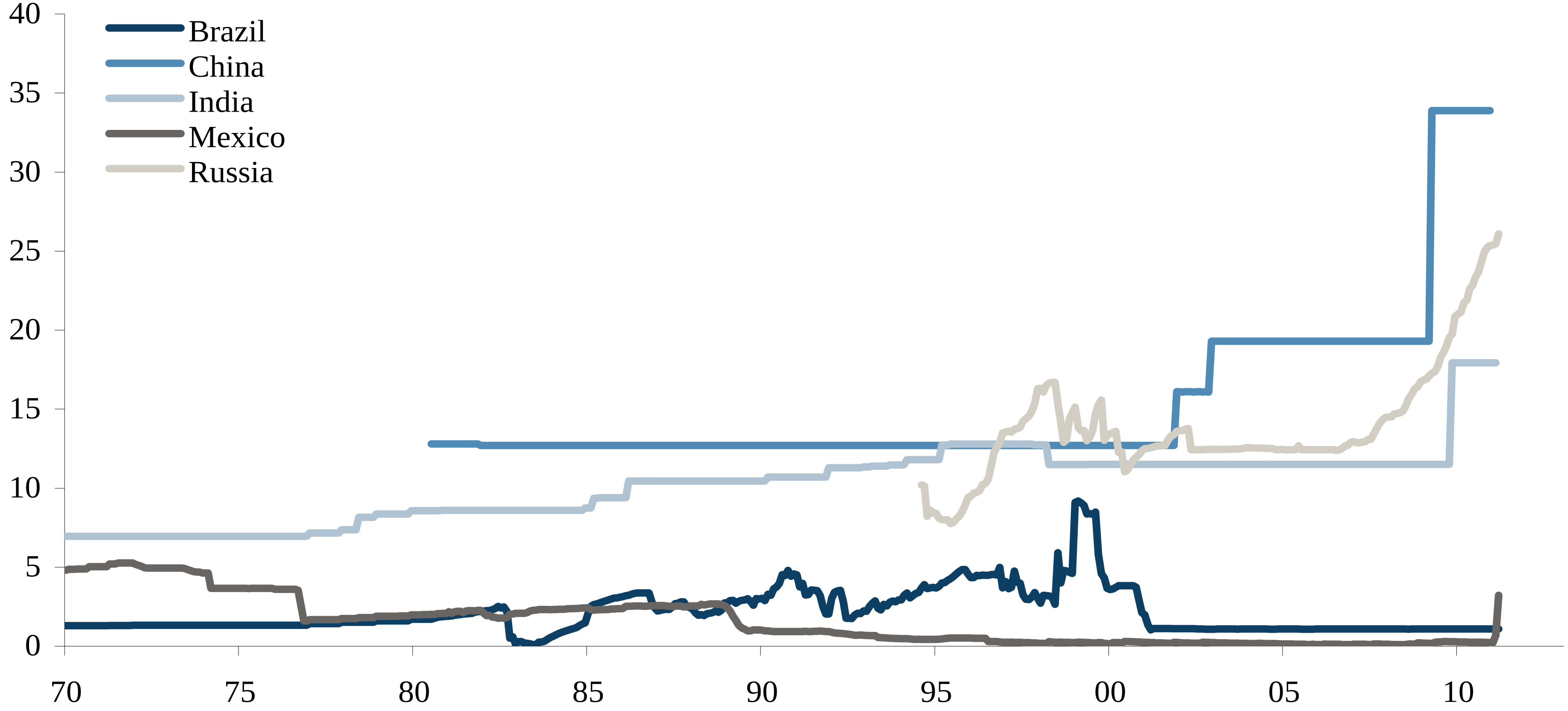
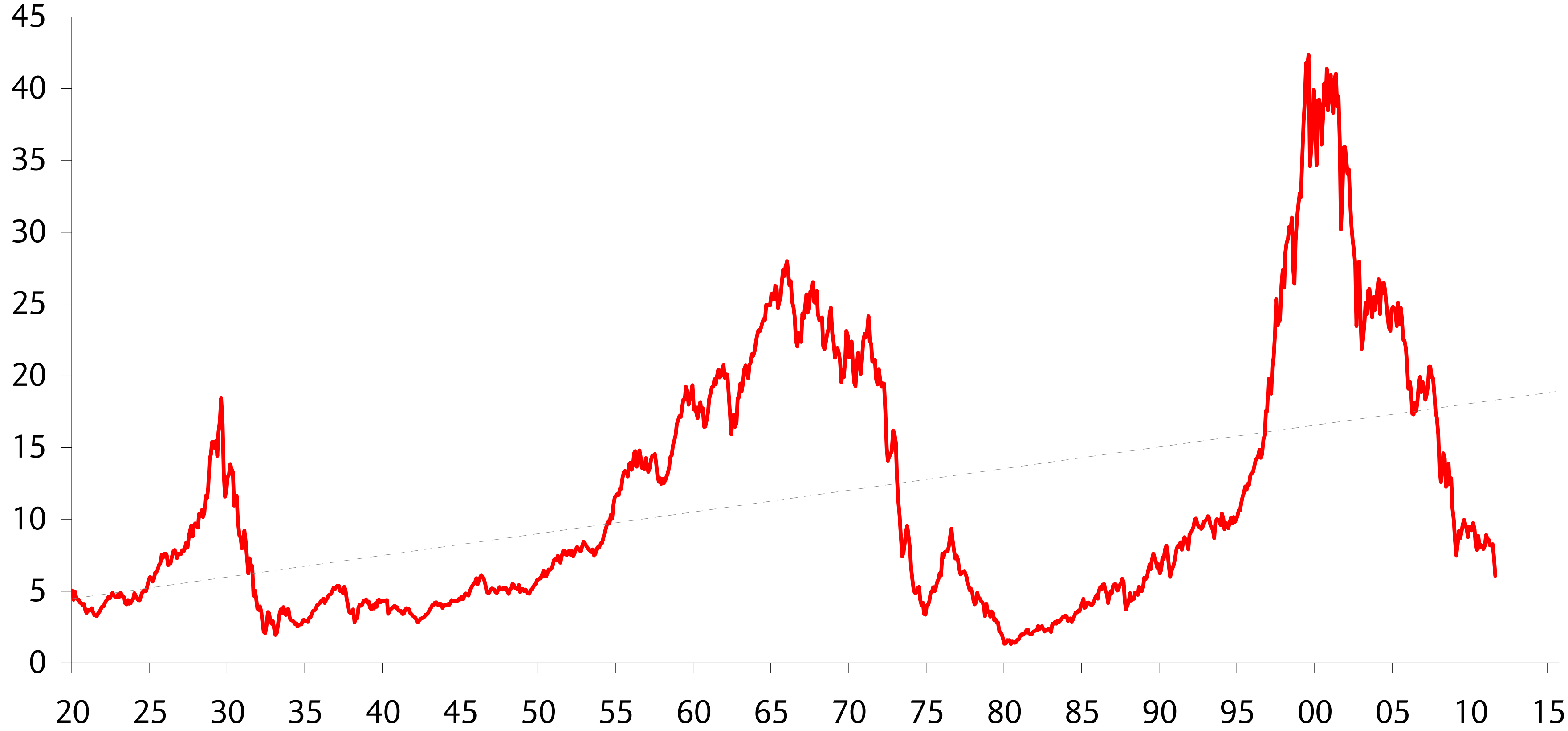
Official gold reserves, ounces mn



Source: IMF, Bloomberg.

US Dow Jones stock market index relative to US$ price of gold per oz



Source: Bloomberg, own calculation.

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