Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

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Dennis Tubbergen:

You are listening to RLA Radio. I'm Dennis Tubbergen, your host. And joining me on today's program is Mr. Alasdair McLeod. Alasdair is Head of Research at GoldMoney. You can learn more about GoldMoney at goldmoney.com. Alasdair is a prolific author and commentator. You'll find his work on the Insights section of the website. I go there frequently and encourage you to do so as well. Alasdair, welcome back to the program.

Alasdair McLeod:

That's my pleasure, Dennis.

Dennis Tubbergen:

Let's just jump right in, Alasdair. As we talked, we're living in a world that certainly is not boring. There is a lot going on from a currency perspective as it relates to the Russia-Ukraine situation. I'd like to focus there in our interview today if we could. I think just to use this as a jumping off point, and you can go any direction you'd like, it seems that, and I'd like your opinion, did the US and did they make a policy blunder when they seized Russian assets here in the US?

Alasdair McLeod:

Yes, I think they have in the sense that it's not just a simple matter of sanctioning the Russians. The problem is that America is leading the sanctions' regime against probably the most important exporter of commodities generally and certainly the largest exporter of energy in the world.

Alasdair McLeod:

You don't do that without having repercussions. I think that's basically what we're seeing. We've seen commodity prices rise fairly sharply and particularly the price of oil, which at one stage got up close to $130 a barrel, but it's backed off about 30% from that now. And natural gas has also rocketed. The prices are pausing, but it does look to me as if they are set to go higher, which of course is very, very painful for particularly the European partners in this Western Alliance against Russia. The answer basically, Dennis is yes, there are some very unpleasant repercussions from the action.

Dennis Tubbergen:

You know, let's talk about now, if you could, just for our listeners, maybe that aren't familiar with this, could you just briefly talk about Russia's reaction to the sanctions and these actions?

Alasdair McLeod:

Yes. Russia has basically done two things. The first thing that the Russian central bank has done is that it's said that between now and the middle of the year, the end of June, it stands prepared to buy gold at 5,000 rubles, a gram. At the current ruble rate, which is a little below 80 to the dollar, effectively means that they're buying gold. They're prepared to buy gold from their own banks. What they call credit institutions in Russia at a price of a roundabout, $1,950. That's a little bit above where we are now. I'll just continue with that for a moment before coming onto the other announcement. The importance of this is that there is no restriction at all on a Russian bank say trying to do an arbitrage, a Russian bank could either go and deal in Shanghai or alternatively could deal with Dubai, buy gold and do the arbitrage into the Russian central bank.

Alasdair McLeod:

Now, obviously the exchange rate is the important thing, the exchange rate between the dollar and the ruble. The other thing that's important of course, is that the Russian bank doing that has to have access to non-ruble currencies. Predominantly dollars in order to do it, the Gazprombank, which is the banking arm of the big energy company in Russia has not been sanctioned. I can see it taking advantage of this perhaps, which would have the effect of draining a physical gold out of really a very illiquid market in the west. That's the first point. The second point is that Russia has insisted that anyone on the unfriendly list, in other words, those who are sanctioning Russia would have to pay for their energy in rubles. Now there's not a huge amount of rubles circulating outside Russia.

Alasdair McLeod:

So, this is obviously going to create something of a shortage of rubles, but having said that the choice for the EU, which in some cases, some of the nation’s rely for up to 40 percent, to their natural gas from Russian sources. They can either get the rubles and get gas at a reasonable price, or alternatively, if they decide that they're not going to buy rubles, not play Russia's game, then they'll just have to take their chances on the international market. And that is likely to drive the price quite a lot higher. I think as far as Russia is concerned, a bit of a win-win as it were. But there is another important point about it because if you put these two things together effectively, the link with gold ties the ruble loosely admissibly to commodities, particularly energy rather than let's say, just operating as a purely volatile fiat currency, liable to sanctions from the west.

Alasdair McLeod:

Russia in currency terms, from these two announcements, it's actually going in a completely different direction from that of the dollar, the Euro, the yen, which basically are committed to expanding the quantity of currency and circulation so that everybody can buy anything they want at whatever the price might be. And this is why the currencies are being debased in the west. What we see is that, from these two announcements, Russia is, if you like, protecting itself from the currency debasement, which looks like accelerating in the west as a result of these sanctions.

Dennis Tubbergen:

Alasdair in the past, when we have chatted and it's been since December now, so about five months or so, you've talked about the fact that a hyperinflationary environment certainly would be something that we might expect here in the west. Is this the first step, or is this a catalyst toward that outcome?

Alasdair McLeod:

It's very much a catalyst towards it. It's accelerating the process, of that there can be no doubt. The interesting thing to look at is the situation in Japan. The Japanese currency is really falling quite rapidly against the dollar. This is very much in contrast with, what are now becoming commodity backed currencies, such as the Chinese renminbi, which is actually increasing against the dollar. The problem that the Japanese have is that the central bankers anchored its interest rates below the zero bond. It has got a huge, great portfolio on board. This is the central bank of JGB, which are Japanese government bonds, corporate bonds, and even equities. They've got substantial quantities of equities. They have been doing this since the year 2000. Now what this means is that this central bank, which amounts to an enormous hedge fund is rapidly going underwater.

Alasdair McLeod:

When we see rising bond yields, driving down the prices of the bonds in their portfolios. We have a situation where they can't afford to raise interest rates. They cannot afford to see higher Japanese government bond yields. They're stepping in to ensure that the ten-year bond, JGB bond yield, doesn't go over a quarter of a percent. They're buying anything they can just to stop these prices falling. This is against the background of price inflation at the consumer level, which all around the world is just through the roof. Obviously, it's a completely untenable situation. What it amounts to is that Japan is already sacrificing its currency in order to protect its financial system. The other thing is this comes at a time when the Japanese large banks in Japan are very, very highly leveraged. The ratio of the assets to equity in all cases is over 20 times. We have a similar situation in the Eurozone.

Alasdair McLeod:

Now the Euro has been in the bear market against the dollar for a little while. It hasn't been quite so dramatic, but I think it's only a matter of time before exactly the same dynamics start undermining the Euro. In that sense, Dennis, going back to your comment about where are we in this hyperinflation story, we can begin to see this unraveling, particularly in the case of the Yen. And I think we'll also see it in the case of the Euro, and then it's likely to affect the rest of us.

Dennis Tubbergen:

Well, Alasdair we have about a minute left in this segment, a little over a minute. Would you share with the listeners a bit about GoldMoney?

Alasdair McLeod:

Yeah, sure. GoldMoney was established by James Turk. Way back in 2002 roughly to provide a safe haven for people wanting to own true money, which is gold and silver, have it vaulted a number of places around the world on a custodial basis. That's what we do. We have, I think about 11 or 12 vaults all around the world. So, you can select something maybe, which is slightly away from your government just to make it a little harder for them, if they want to come for your gold. We just act pure custodians, we're outside the banking system. If we have a banking crisis, we're not affected and it's a pretty popular service, I'm glad to say. I think anyone who's concerned about having all their interests in this fiat currency world, it is extremely important to consider whether or not they should hedge all that risk by having some gold, some silver stored in a safe location.

Dennis Tubbergen:

Well, that's perfect timing. The clock says we need to leave it there, but the good news is, I will be back for one more segment with Mr. Alasdair McLeod, stay with us.

Dennis Tubbergen:

I'm Dennis Tubbergen. You're listening to RLA radio. I'm chatting today with the head of research at GoldMoney, returning guests, Mr. Alasdair McLeod. Alasdair is a prolific author and commentator, very bright guy. I would encourage you to check out all his work at goldmoney.com and you can go to the Insights section. Alasdair, let's just briefly summarize what we talked about in the last segment with Russia's action here. Is this the beginning of a quasi-gold standard, now that Russia's got this fixed rate at which they will buy gold?

Alasdair McLeod:

It's very interesting because this isn't a traditional gold standard where you could walk into, say the Fed or the bank of England and say, I've got these notes, I don't want them, I want gold, because the exchange rate is $35 an ounce or whatever I want. I want an ounce for every $35. Yeah. That's how it used to be. The central bank was obliged to give you gold coin for dollars. Actually, I think in the case of America is 20.67 because at $35, you weren't allowed to exchange it. This is very, very different. I think what Russia is doing is that it is tying its currency effectively to the world of commodities. I'm just saying this very, very loosely, because it is a very loose tie. They are doing this, I think through gold in a sense, because by saying that they will buy gold at 5,000 rubles per gram.

Alasdair McLeod:

That is only true up until the middle of this year. They will then revise the price at that point. For all we may know they may stop doing it, but I think we can assume that they will revise the price because that's roughly what the statement from the central bank said. This is rather like a floating peg. Now this does make sense because there is so much violence in the world of currencies at the moment being unleashed. In the last segment, I talked about the situation for the Japanese yen and also the Euro. If they fall over God help the rest of us. This is not just a banking crisis in the making. It is also a major fiat currency crisis. And they're likely to be fiat currencies that are not going to survive. The Russians clearly know what they're doing. They want the flexibility to deal with the blow back from what's going on, in what I can only describe as almost, a currency war of almost nuclear proportions.

Dennis Tubbergen:

Alasdair. When you look at the use of the dollar as still the primary currency used in international trade, how does this development affect the dollar's dominance in your view?

Alasdair McLeod:

It is fascinating. We have in the world today, the world of currencies is essentially a world which revolves around collateral, which is financial in character. If you go to a bank and you want to borrow money, basically, it could be a mortgage on your house, but very often, what the bank is really relying on is some sort of collateral in the form of let's say bonds or equities or something like that against which they will offer a loan. The currency situation is effectively backed by financial assets. We are at the end, I believe this is very much the end of major financial bubble, the scope of which we haven't seen on a global scale before. We've had things like the Mississippi bubble in France. We've had the south sea bubble in England. We've had the tulip bubble in Amsterdam, but these are almost sort of local bubbles as it were, but this is a global one. This is truly global.

Alasdair McLeod:

What we are seeing now is the purchasing power of currencies is diminishing at quite a significant rate, which means that interest rates will not go up just 2%, 3%, but they're going to go up a lot, lot more. That of course is going to burst the bubble, not just of bonds, which is already started, but also of equities. We're transitioning from that currency world into a new currency world where the collateral is effectively commodities. I think that Russia and China are basically leading the way in that direction. It's a very, very interesting point in economic history that we're actually sitting at the moment, this transition from collateral being essentially financial in nature on the back of a bubble and moving into collateral being only commodities. Obviously, the whole world doesn't work just on commodities, but there will be a lot of wealth destruction. As the bubble in the west pops, that's going to be the transition, which we are really looking at, over the next year or two.

Dennis Tubbergen:

So, Alasdair, when you say the bubble will pop, the thought is that as bubbles pop, that is a deflationary event and currency creation is an inflationary event. Could you envision a scenario where we see asset prices like stocks and bonds fall while consumer prices continue to rise?

Alasdair McLeod:

Yes, I certainly can. Let's look at just one narrow aspect of consumer prices and that's food. This year we're likely to see developing shortages of food stuffs because of the situation in the Ukraine in particular. Ukraine is the breadbasket of Europe. It supplies an awful lot of grain and fertilizer to the rest of the world, which when withdrawn not only forces up prices, but also means that the productivity of farms outside the region will also be severely affected by the rising cost of fertilizers. We're going to see prices rise and financing that rise will be, further production of currency. That to me is absolutely clear. This idea of tying together, what is happening to the debasement of a currency with financial asset prices gets it all wrong. The problem that financial asset prices are going to have to surmount is how do you retain value in a stock, when interest rates are rising through the roof.

Alasdair McLeod:

As I said earlier, not just 2%, 3%, but it is becoming possible to envisage interest rates going over 10%, just by looking at what's going on to prices in commodities and how that is feeding through in terms of production costs and all the rest of it. So, I think it's always a mistake to think in terms of black and white, which is really a Keynesian approach, has been disproved so often. If you look back at what happened in Germany in 1923, you had the collapse of the currency, the paper mark, interest rates, goodness knows where they were. If you could borrow money, it would've been a ridiculously high interest rate. What happens to stocks and things like that? Any value that was there was basically because you had an alternative to dealing in the paper market, people were buying, they were buying things using foreign currencies. This time we just don't really see where that alternative is going to come from.

Dennis Tubbergen:

So, Alasdair, when you were describing that scenario, one of the thoughts I had was that this really is going to force governments around the world to come a lot closer, to getting their financial houses in order, and that's going to be extremely painful for the populous. Would you agree with that thought?

Alasdair McLeod:

I would certainly agree with this. I don't think it's quite as simple as we would like to think because Western governments have mandated costs, which they can't avoid without changing laws. Those mandated costs, in America we've heard about all Medicare and all this sort of stuff, which is just going through the roof cost wise. We've got the same thing here with the national health service. How does the government back out of those responsibilities? It needs to change the law in order to do so. I just can't see how they can deal with this. The only thing that a democratic country in this situation can do is just, print, print, print. Get the central bank to buy however much debt at whatever interest rate it is in order to finance these government obligations.

Dennis Tubbergen:

But that's got an end game. Right. Alasdair, that can't happen. That can't go on for a long time. That's going to be just like, putting the proverbial finger in the dyke before everything blows. Correct?

Alasdair McLeod:

Absolutely. Right. The point behind that then is that you are destroying your currency and that's what we're seeing. We're beginning to see evidence of the currency sliding in the Japanese yen. We haven't seen it so obviously in the Euro but remember that the Euro has declined against the dollar from, 130 down to currently 108, that's not exactly performing well. We're measuring the Euro in this case against a paper currency, which I wouldn't say is the most secure thing, yardstick to measure anything against.

Dennis Tubbergen:

So ultimately, and we've got about a minute and a half left in this segment. Does the world experience an environment similar to the 1930s, or is it going to be worse this time?

Alasdair McLeod:

It's a difficult question to say. It's obviously different because in the 1930s we had sound money so that the Wall Street crash, which was brought about by the end of bank credit expansion in 1928, 1929 is a similar situation. The pricing of it is looking very, very different. Here we're pricing everything in fiat currency. What happens this time is that instead of everybody suffering from the deflation of prices as economists like to call it, but which rarely was, real prices in gold this time, we will see prices being maintained. Prices in fact rising in the same situation, because the currencies will be depreciating more rapidly than the loss, in real terms represented by, the values of goods and services.

Dennis Tubbergen:

My guest today has been Mr. Alasdair McLeod. You can check out his work at goldmoney.com. I would certainly encourage you to do that. Alasdair, never have enough time when I talk to you, but I always appreciate catching up with you. I know my audience appreciate your perspective as well. Thank you for joining us today.

Alasdair McLeod:

My pleasure, Dennis. Thank you.

Dennis Tubbergen:

We will return after these words.