

Part 1 - 2014 the year of truth! A US dollar crisis, interest rates spiking and worldwide debt growing out of control and gold and silver through the roof!

A dollar crisis could be around the corner

The main question stemming from the \$10bn tapering announced by the Fed is who will buy the \$10bn treasuries and MBS that are not bought by the Fed in January 2014 and what will be the ultimate result! See below what happened since the Fed first started talking about tapering in May of 2013, interest rates started to rise. Tapering is in my point of view a relative tightening; surely the amount of money pumped into the market every month is suddenly \$10bn less! Based on 41 economists surveyed by Bloomberg on Dec. 19, the Fed will reduce its buying by \$10 billion in each of the next seven meetings before ending its stimulus in December.



In my point of view we are between a rock and a hard place and it doesn't matter if:

- The economy improves:** If the "reported" figures from the Government (who trusts Government figures any longer) that the economy is "improving" (an increase in business inventories contributed 1.7% to third quarter GDP growth of 4.1%) are getting "stronger and stronger" the Government will shoot itself in the foot because the threat of further tapering will increase interest rates and will implode the bond market. Worldwide debt levels are in excess of \$220trn and growing by 11% a year and 3 times bigger than world GDP of \$72trn, which is only growing 3%-3.5% per annum! We can't possibly afford higher interest

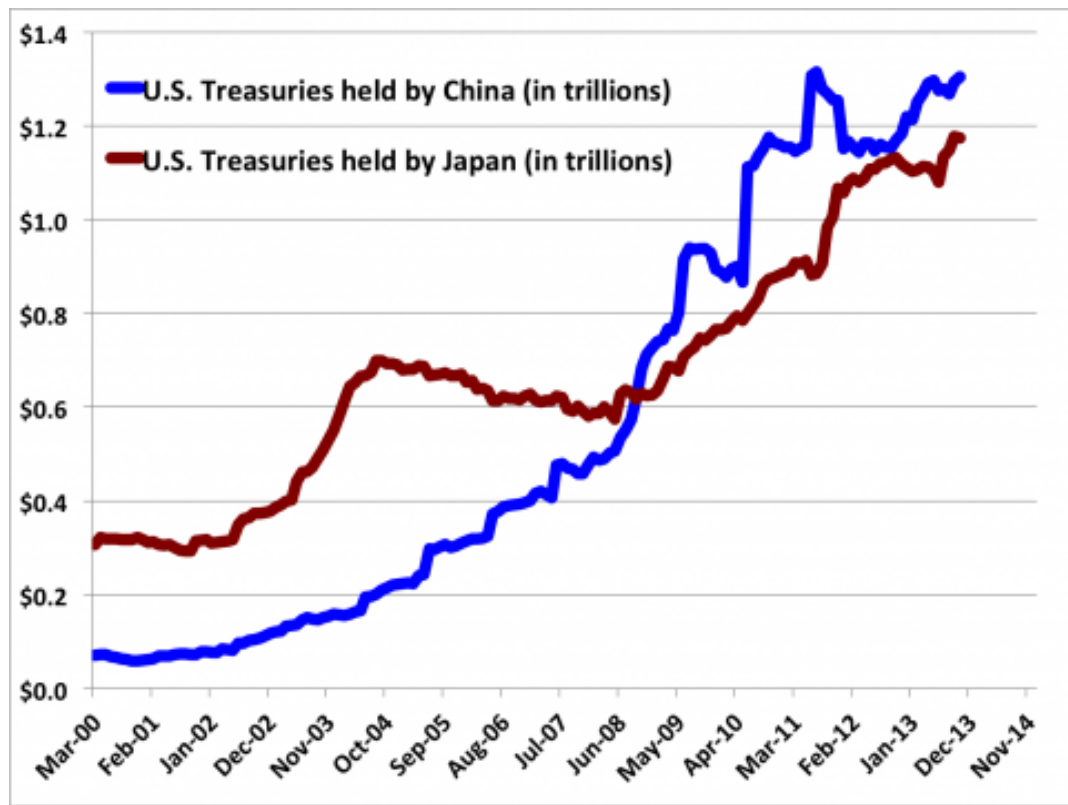
rates or more debt. From a mathematical point of view it is impossible to repay the outstanding debt anyway and it is getting more difficult by the day. Foreigners own approximately \$5.6trn in Treasury securities, or about 47% of the debt held by the public amounting to \$11.9trn. Foreigners could sell the US bonds, which would put downward pressure on the US dollar and could create a currency crisis.

2. **Or if the economy doesn't improve:** In this situation Q4, 2013 or Q1, 2014 GDP figures will be so weak following the artificially strong figures of the third quarter that the Fed might have to increase the amount of QE again to \$85bn or even \$125bn. Another indication could be the already published December unemployment figures. Whilst 193,000 new jobs expected the U.S. added just 74,000 jobs in December to mark the smallest increase in 3 years. Without the seasonal accounting adjustment December non-farm jobs actually fell by 246,000!! The unemployment rate, meanwhile fell to 6.7% from 7.0% to mark the lowest level since October 2008, for a large part because more people dropped out of the labor force — some 347,000, as a result of which the civilian participation rate fell two ticks to 62.8%, matching a 35-year low!!! Many Americans were no longer looking for work in December because they have become so disillusioned by the lack of jobs. By denying extra benefits to jobless workers, Congress could trigger a sharp decline in the nation's 7% unemployment rate and paradoxically make the labor market look healthier than it is. In the end this weakness could potentially cause a major US dollar crisis because investors will conclude that it doesn't matter how much paper (money) the Fed throws at the system it just doesn't work! See how much the dollar declined as a result of the weak employment figures on Friday January 10! Is this the foreboding of what is coming?



All credibility in the Fed will be gone as if it hasn't lost its credibility yet with all the different stories that the Fed doesn't have a clue of how to get out of the QE and what the consequences could be! A dollar crisis would also cause the

bond and equity markets to implode because a strongly weakened dollar will cause interest rates to spike and gold and silver will thrive. In the context of a possible US dollar crisis it is important to look at the two largest foreign treasury holders, China and Japan.



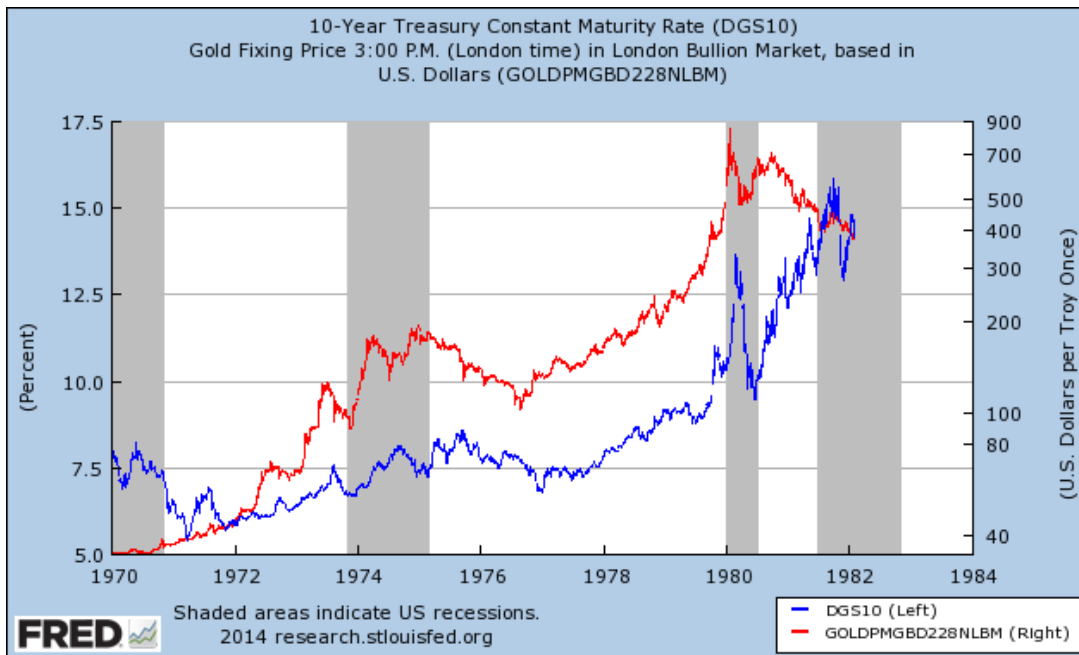
Business Insider/Matthew Boesler (data from Bloomberg)

Since 2008, China has been the largest foreign holder of U.S. government debt. China's portfolio of U.S. Treasuries totaled \$1.305 trillion at the end of October, just shy of the \$1.315 trillion peak value registered in July 2011. Japan's portfolio of U.S. Treasuries was valued at \$1.174 trillion at the end of October. Number three would be the Caribbean offshore centers with approx. \$300bn with Brazil and the Oil exporting countries each good for \$250bn (source: US Treasury Department).

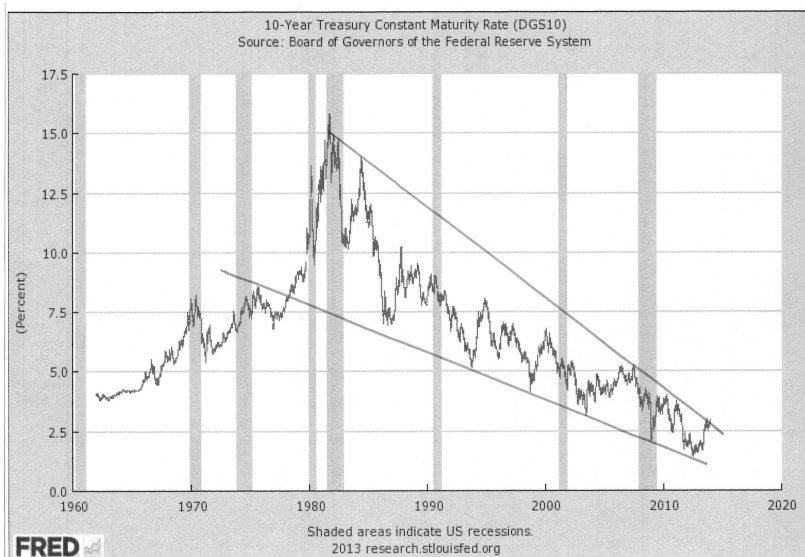
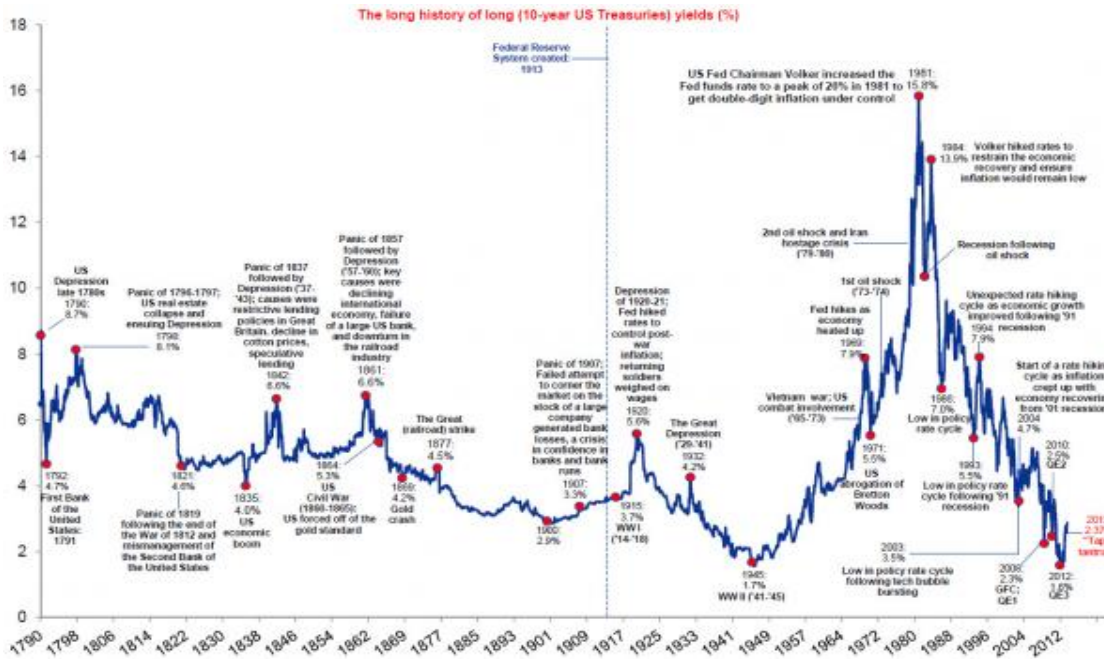
However, China's position as America's largest creditor could be eclipsed in 2014, by Japan because Japanese investors could be forced to seek higher yields overseas and especially if China continues to diversify its holdings away. In a speech November 2013, People's Bank of China deputy governor Yi Yang declared it "no longer in China's favor to accumulate foreign-exchange reserves." Yi's comments triggered speculation that China will become less of a source of foreign demand for Treasuries going forward. China has actually been reducing its allocation to Treasuries for a while in favor of very aggressive

accumulation of gold reserves. The Chinese are even approaching gold mining companies directly in order to buy the gold from the mines at attractive premiums!

Also with higher interest rates gold and silver do well look at the following chart. It shows that from 1971 to 1980 when the 10y yield rose from 5.5% to 14% the gold price rose from \$40 to \$850 an ounce.



As the chart below shows interest rates are at their lowest since 1790. Next to that we are at the verge of breaking out of the 32-year downtrend for the 10y treasuries that started with Volcker raising interest rates to combat inflation in 1981. So how much better can it get, think about it! Not! And if interest rates go much lower it will be an indication that indeed something is terribly wrong.



And what definitely won't help is that fact that the world's biggest economies will need to refinance \$7.43 trillion (\$7,430bn) of sovereign debt in 2014 as bond yields begin to climb from record lows, threatening to raise borrowing costs while nations struggle to bring down elevated budget deficits. At \$3.1 trillion, representing a 6% increase, the U.S. faces the largest tab. The key here is demand rather than supply, do you bondholders believe that holding US Treasuries is a good investment. The majority of forecasters in a Bloomberg survey who say U.S. borrowing costs will increase. They anticipate yields on the 10-year notes, which rose 1.27 percentage points last year to 3.03%, the highest since 2011, will climb to 3.38% on average.

Following is a table of projected bond and bill redemptions and interest payments in dollars for 2014 for the Group of Seven countries, Brazil, China, India and Russia using data compiled by Bloomberg as of Dec. 30:

Country 2014 Bond, Bill Redemptions Coupon Payments

U.S.	\$3,115 billion	\$218 billion
Japan	\$2,383 billion	\$87 billion
Italy	\$468 billion	\$79 billion
France	\$410 billion	\$61 billion
Germany	\$268 billion	\$39 billion
Canada	\$248 billion	\$13 billion
U.K.	\$181 billion	\$75 billion
China	\$143 billion	\$58 billion
Brazil	\$121 billion	\$24 billion
India	\$85 billion	\$47 billion
Russia	\$10 billion	\$11 billion

And believe me, when we break out of the 32-y downtrend the results won't be pretty. **The argument often heard that interest rates from a historical point of view are still low at 3%-4% doesn't have any validity in my point of view. When you break out of a 32-year trend the movement is most likely to be violent.** Everybody owns treasuries and debt instruments (interest rate derivatives that are estimated to be in excess of \$400trn, not billion trillion, could create a nuclear fall-out if the rate of change is too rapid especially if one considers the impact the amounts of debt will have) and everybody most likely wants to get out at the same time. The impact will be felt worldwide, because all debt is interconnected through the currencies and in the end everybody owns the same debt.

It is therefore in my point of view essential to look at debt on a worldwide scale and evaluate what it potentially can do to our financial system. We saw what happened to emerging market debt rates and their currencies when the Fed just mentioned tapering in May of 2013. Anyway my point is that debt or debt levels and currencies are strongly interconnected. As a rule low debt levels most likely reflect a strong currency whilst high debt levels and other weak fundamentals in general will express themselves in a weak currency.

Don't forget in the end the currency is the ultimate benchmark of your wealth that is why the currency and the outlook for your currency is so important. And as such it is understandable why there is such a stand-off between gold and the reserve currency because the strength or weakness of gold signifies the opposite weakness or strength of the US dollar. This gold versus US dollar dynamic is crucial in understanding the reasons behind the movements in the gold price. I would like to emphasize that the 79 and 74 levels for the USD index (see below) are considered crucial for a potential breakdown of the US dollar.



There is no historical precedence for a fiat currency, different from gold and silver that has succeeded in holding its value.

According to a study of 775 fiat currencies by DollarDaze.org, “there is no historical precedence for a fiat currency that has succeeded in holding its value. Twenty percent failed through hyperinflation, 21% were destroyed by war, 12% destroyed by independence, 24% were monetarily reformed, and 23% are still in circulation approaching one of the other outcomes.”

“The average life expectancy for a fiat currency is 27 years, with the shortest life span being one month. Founded in 1694, the British pound Sterling is the oldest fiat currency in existence. At a ripe old age of 317 years it must be considered a highly successful fiat currency. However, success is relative. The British pound was defined as 12 ounces of silver, so it’s worth less than 1/200 or 0.5% of its original value. In other words, the most successful long-standing currency in existence has lost 99.5% of its value. Given the undeniable track record of currencies, it is clear that on a long enough timeline the survival rate of all fiat currencies drops to zero!” In fact, since the Federal Reserve act of 1913, the U.S. dollar has lost 98% of its value.

Hence why we see a lot of alternative forms of currency (a medium of exchange) being born, such as Bitcoin, because people don’t trust existing fiat currencies, due to their deteriorating purchasing power. Again if the fiat currencies issued by Treasuries would be strong there would be no need for alternative virtual currencies. It is due to the irresponsible and undisciplined behavior of the monetary authorities and politicians that we have run away debt levels and budget deficits, which resulted in the US dollar losing 98% of its purchasing power since 1913.

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