

MONEYIZATION #14

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THE VALUE VIEW GOLD REPORT

Moneyization: The global financial phenomenon of individuals and businesses moving their funds to monies in which they have the highest confidence, or money which has a higher store of faith.

Or, Devaluation of Dollar Has Started

Waking up this morning, 21 July, the world was a little different. Before our feet hit the floor, more than US\$200 billion of purchasing power was destroyed. Ultimately and in total, hundreds of billions of dollars of real value will be destroyed by the upward valuation of the Chinese renminbi. That \$200 billion dollar number is simply the degradation in value of U.S. dollar M-3 alone, a broad measure of money supply. If you have had your wealth in dollar denominated assets, before your morning coffee you were 2% poorer. Foreign central banks alone lost \$30+ billion of purchasing power, based on their holdings of U.S. government debt.

While that was happening, chaos was running rampant in London due to a terrorism scare. With all this excitement, the morning question for viewers on CNBC was the following:

Which is a better buy? Google or EBay.

Huh? The burning issue of the day? Perhaps the time has arrived for adults to be put in charge of the cable business media. Maybe the producers of CNBC just need to put down their Harry Potter books in the morning. At least we are gaining some insight into why so many people are going to be reading Harry Potter rather than watching television.

Moneyization is the force pushing the Chinese renminbi's value up. The amount of money that has flowed into China to escape the devaluation of the dollar has been so great that the People's Bank

of China really had no choice. The U.S. dollar had to be devalued. Investors, businesses and just plain, common folk have learned to move their wealth to monies of higher faith. **Their faith in the Chinese renminbi is greater than their faith in the U.S. dollar. A new paradigm perhaps?**

That this action is being referred to as a devaluation of the U.S. dollar is very intentional. **A global power relationship has been altered by this action.** China is dictating the value of the U.S. dollar. For over 70 years, the U.S. has been dictating the world's financial terms. More than a 2% change in money values is involved. The future for global monetary history is unfolding. Do not take lightly what has happened.

The implications of the devaluation of the U.S. dollar by the People's Bank of China are many, some of which will remain hidden for a considerable time. A short-list, which should certainly not be considered complete, of the ramifications are as follows:

- ◆ U.S. trade deficit will rise
- ◆ Purchasing power of dollar denominated assets reduced
- ◆ Bank of China will buy less U.S. government debt
- ◆ U.S. interest rates will rise
- ◆ Argument over U.S. housing bubble will be resolved
- ◆ Reduction in U.S. military power
- ◆ China is rising global monetary hegemon
- ◆ \$Gold will rise in price, Gold price of U.S. dollar will fall
- ◆ Obsolescence of national monies, like Canadian dollar, accelerated
- ◆ Who would have guessed ten years ago that the People's Bank of China would determine \$'s value?

In the short-term especially, the U.S. trade deficit will rise. Trade deficit with China will increase as the price of Chinese goods will rise in terms of dollars. The modest dollar devaluation will not cause factories to be put on boats and transported to new sites in the U.S. That artificial Christmas tree or microwave oven that some U.S. consumer plans to buy will still be bought. They will just pay more for it. Consumers are not going to just buy 98% of a microwave. They have to buy the whole thing. One of the messages of this article, which had been in planning before the Bank of China acted, is that the U.S. has a structural trade deficit that for the foreseeable future is immune to the value of

national monies.

Higher prices for imported goods means that the purchasing power of anyone that is dollar denominated has been reduced. Dollar denominated people are poorer this morning, and destined to become poorer. The humor writers working for the U.S. government may not be able to continue issuing fictional inflation numbers in the future. **Reality is that U.S. dollar denominated wealth and income are worth less this morning, and the future trend is negative.** Such is true, regardless of the comedy routine called inflation reporting in the U.S. In the card game of the real world, Bank of China trumps hedonic adjustments.

The devaluation cat is out of the bag. China has unleashed the future for national money values. National money values will likely now be more determined by money flows, the markets, rather than delusions over U.S. economic growth and the power of the Federal Reserve. For until today, two big players existed in the world of national monies. However, the U.S. is increasingly unable to exercise hegemonic control due to the debt situation. And unfortunately, Europe lacks the unity to supervise the global money system. By this action, China is now stepping into a meaningful roll in global finance. How will they exercise that power and what will be the impact? Whatever the answers to these question might be, owning the dollar and being short Gold or Silver are not the right ones.

As mentioned above, the devaluation of the U.S. dollar will have little impact on the U.S. trade deficit. Remember, the U.S. trade deficit is the central problem and the culprit of the dollar's fall. The structural trade deficit of the United States prevents minor dollar devaluations from being effective. To understand the situation, consider the first graph. The first graph plots two data series. U.S. monthly trade deficit, in thousands of dollars, is plotted with small squares, and uses the left axis. The solid line is the number of workers employed in goods producing industries, and uses the right axis in thousands of workers.

First Graph



The big picture is fairly easy to grasp. U.S. trade deficit has tended to get bigger over most of the time period shown. Employment in goods producing industries, people doing real work and making real things, rose, peaked, and has declined to a level about that at the start of the graph. Two trend lines have been added to help identify the changing situation, and note the demise of U.S. manufacturing.

In the early part of the graph, the employment trend is extremely positive. The slope of the trend line is fairly steep. During the early 1990s, the U.S. added considerably to employment in real industries. During that period the trade deficit increased in a moderate fashion to about minus 10 billion dollars a month. The second trend line, with a much flatter slope, highlights the beginning of a shift. The number of workers added to employment for producing real goods and stuffs slowed dramatically. A vertical bar has been inserted to help identify the timing of that shift. During this period, the U.S. trade deficit increased to a negative \$30 billion a month.

However, a serious problem was then about to begin. Employment in real work collapsed in the U.S.,

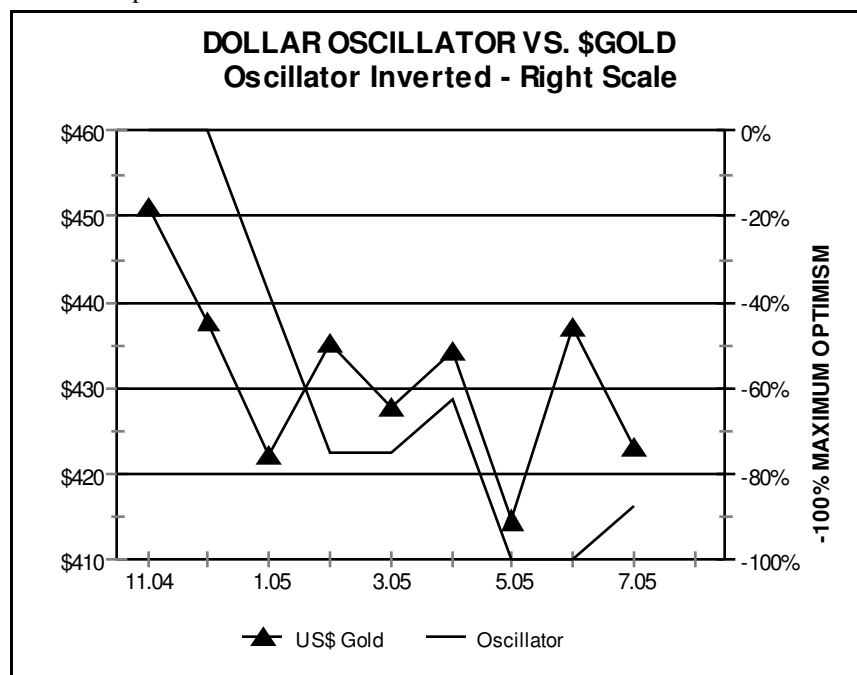
and reached a level below that which existed in 1991. A modest upturn has occurred, but certainly no explosion in employment. Most of the workers added in the U.S. are involved in activities like processing mortgage applications, or similar non-work. The U.S. trade deficit, out of necessity, collapsed to its current level in the negative \$55-50 billion range. U.S. trade deficit exists because the factories, the real workers, the real production are increasingly in other countries. That trade deficit can only grow as employment in the U.S. is increasingly concentrated in services, forms of non-work.

A 2% devaluation of the dollar will not cause factories in China to be put on boats and transported to North Carolina. What will it take? 10% devaluation? 25% devaluation? 4 yuan to the dollar? A \$3 Euro? At this point, only the direction for the dollar is known. The structural trade deficit of the U.S. means that the dollar's devaluation has only begun, and that it is a long term bear market.

The dollar has been, for a number of months, in a false rally. A popular delusion on Wall Street has been that the dollar's strength would continue. The thinking being that any nation that could create Google, which makes it easy to search for trivial sites on the net, and EBay, an electronic flea market, was too important not to draw investment dollars. Focus on such trivial business ventures as these are exactly the reason the U.S. has a trade deficit. Google and EBay are not cures for cancer. This thinking though created a seriously over bought condition for the U.S. dollar. **China's devaluation of the U.S. dollar is a bell ringing that this situation is about to be reversed.**

Our second graph portrays \$Gold with triangles, using the left axis. The solid line is an oversold/overbought oscillator for the U.S. dollar. The latter is built on stochastic techniques, and calculated on a monthly basis. That measure has been inverted, and uses the right axis. A reading of minus 100 is maximum dollar optimism. The negative plot lets it move more closely with the \$Gold price. In May, optimism reached a peak and \$Gold bottomed. The oscillator is now moving up, much as astochastics change when the price trend changes. **China's action suggests that the trend will now be away from dollar optimism.** On a strategic basis, Gold's price trend has changed and investors should be taking advantage of this condition to buy Gold, and Silver.

Second Graph

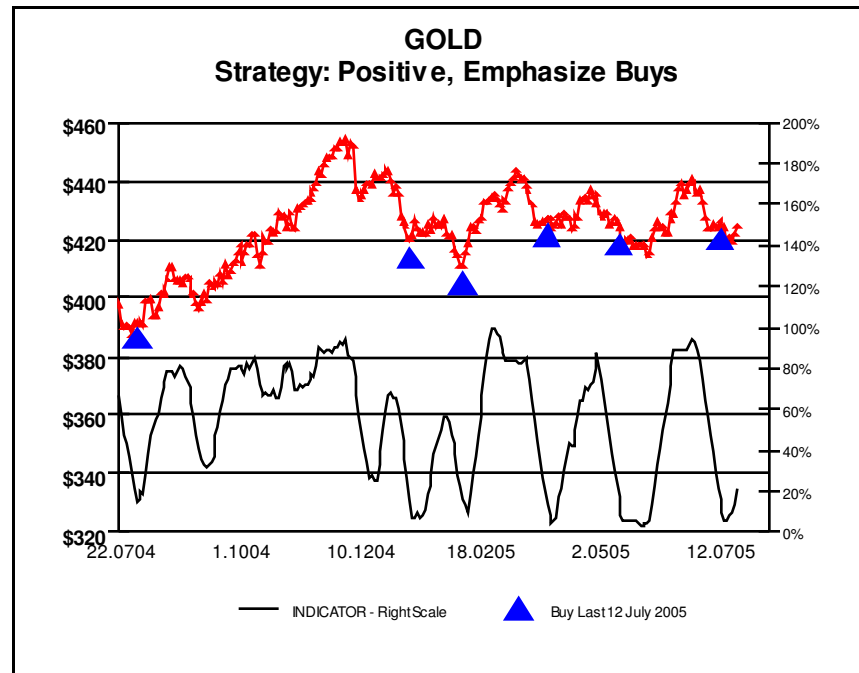


One of the ramifications of China's move to devalue the dollar over time is extremely negative for U.S. interest rates, and therefore for housing prices. When China was keeping the relationship between renminbi and the dollar fixed, the Bank of China was forced to make massive purchases of U.S. government debt. These purchases were part of the process of sterilizing the massive dollar inflows into the country. Without those purchases the renminbi might have been forced dramatically higher, something the government did not want to happen in the short run.

As a consequence of the devaluation of the U.S. dollar, the Bank of China purchases of U.S. government debt will be smaller. Rationale for making those purchases being partially muted by the devaluation of the dollar. The same will be true of other nations. One of the little bells that rang this morning was for the beginning of the end of foreign central bank financing of the U.S. deficits. Less demand for U.S. debt means higher interest rates. Of course the Federal Reserve will fight the trend, but global markets are bigger than any central bank staffed by mere mortals. U.S. interest rates are headed far higher than any expect. Housing prices will take a far bigger dip than any believe. The U.S. Great Recession will start in 2006. 4 yuan to the dollar and a \$3 Euro are more likely than many can fathom!

Last Graph

Source: *The Value View Gold Report*



While contemplating the many ramifications of the devaluation of the U.S. dollar by the People's Bank of China, a review of the Gold market would be timely. As the dollar price of Gold rises when the value of the dollar falls, Gold, and Silver, should be added to your portfolios. On a strategic basis as shown in the earlier graph, the massive level of over optimism on the dollar is providing Gold prices that should not be ignored. In the last graph are portrayed strategic buying points created by vacillations in optimism over the dollar. Recent buy signals suggest that Gold is attractively priced for dollar denominated investors and those in countries, like Mexico and Canada, that are closely tied to the dollar. **The conductor blew the whistle this morning for the train departing to \$1,300 Gold. Get on board!**

Ned W. Schmidt, CFA, CEBS is publisher of *THE VALUE VIEW GOLD REPORT*. That report now includes a weekly message, *TRADING THOUGHTS*, to help investors identify timely points for buying Gold and Silver. You can join him for the Gold Super Cycle at http://home.att.net/~nwschmidt/Order_Gold_EMonthlyTT.html His monumental report, "\$1,265 GOLD", which has now been read in 12 countries, has 255 pages and 98 graphs, is available at

www.amazon.com or from the author. Ned welcomes your comments and questions. His mission in life is to rescue investors from the abyss of financial assets and the coming collapse of the U.S. dollar. He can be contacted at nwschmidt@earthlink.net.