Gold in 2024

To market observers, gold appears ready to break into new high ground measured in all the major currencies. In fact, it is the currencies' collapse in their values, rather than gold rising. Appreciating this distinction is vital for understanding the future of the gold/currency relationship.

To support this thesis, the relative price volatility for commodities and energy in dollars and gold are compared. Gold wins hands down as the objective value in commodity transactions. It is hardly surprising, bearing in mind that gold is legal money and currencies are credit with counterparty risk.

Therefore, the prospects for the dollar as the leading fiat currency should be considered, not gold. And the outlook for the dollar is not good. Going into a recession, commercial banks are highly leveraged, so credit is being withheld from the private sector, guaranteeing a deepening recession. It is from here that stimulus and corporate rescues will add additional deficit spending, which will be highly inflationary in nature.

The current decline in bond yields will prove to be misleading. The outlook for both inflation and time preference is for higher rates instead.

To make matters worse, the US Government is ensnared in a distressing debt trap. And beyond current short-term funding by T-bills, sufficient buyers of US Government longer-term debt are hard to discern. Foreigners, who have been the marginal buyers in the past, are becoming net sellers.

2024 is shaping up to be the year when the dollar loses international credibility, and its value measured in real, legal money — which is only gold — will decline accordingly.

The monetary perspective — whether to forecast values for gold or fiat currencies

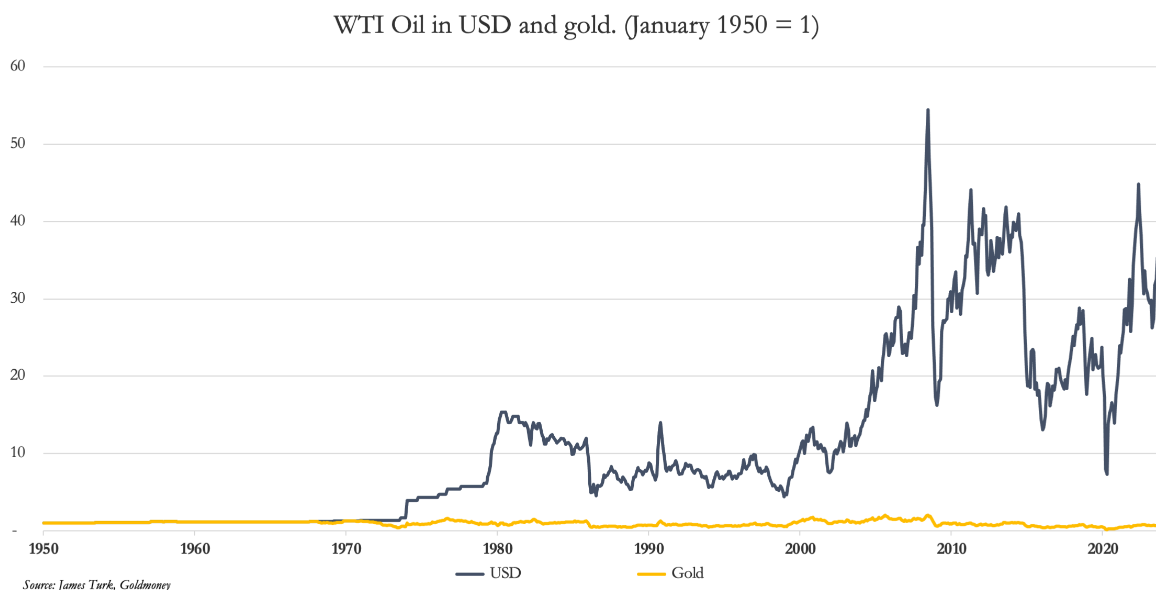
This is the time of year when precious metal analysts review the year past and make predictions for the year ahead. Their common approach is of investment analysis — overwhelmingly their readership is of investors seeking to make profits in their base currencies. But this approach misleads everyone, analysts included, into thinking that gold is an investment when it is in fact the ultimate form of safe liquidity.

Most analysts have been educated to think gold is not money by schools and universities with curriculums which promote post-Bretton Woods macroeconomics. If their studies had not been corrupted in this way and they had been taught the legal distinction between money and credit instead, perhaps their approach to analysing gold would have been different. But as it is, these analysts now think that cash notes issued by a central bank are the new money when very clearly it is credit with counterparty risk, and it is accounted for as such on a central bank balance sheet as a liability. Under any definition, these are the characteristics of credit with matching debt obligations.

Nor do the macroeconomists have a cohesive explanation for why it is that central banks continue to hoard massive quantities of gold bullion in their reserves. Furthermore, some governments even accumulate gold bullion in sovereign wealth funds and other secret accounts in addition to their central banks' official reserves.

The prudence of central banks and Asian governments following this approach was illustrated when the western alliance led by America defaulted on the Russian central bank's currency reserves with little more than the stroke of a pen. This is the other side of proof that the legal distinction between money and credit remains, despite any statist attempts to redefine their currency as money. That it can be reneged upon by the issuer further confirms its credit status.

We must therefore amend our approach to analysing gold and also silver. Other precious metals have never been money, so are not part of this analysis. Silver was dropped as an official monetary standard long ago, so we can focus on gold. With respect to valuing gold, the empirical evidence is clear. Over decades, centuries, and even millennia its purchasing power measured by commodities and goods on average has varied remarkably little. But we don't need to go back centuries: an illustration of energy prices since the dollar was on a post-war gold standard, in this case of crude oil, makes the case for us.

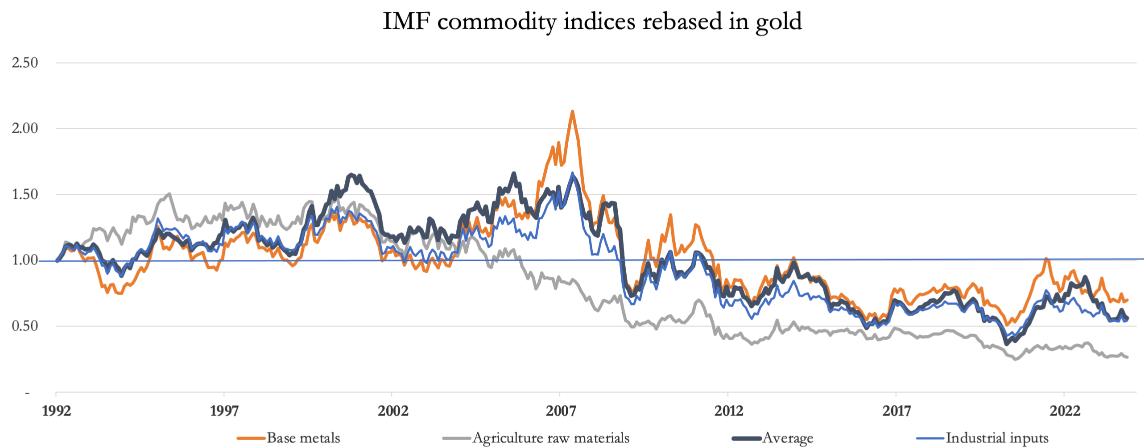


The first point to note is that between 1950—1971, the price of oil in dollars was remarkably stable with almost no variation. Pricing agreements stuck. It was also the time of the Bretton Woods agreement, which was suspended in 1971. Bretton Woods tied the dollar's credibly to gold, until the expansion of dollar credit became too great for the agreement to bear. The link was then broken, and the price of oil in dollars began to rise shortly thereafter.

Priced in US dollars, not only has the price of crude been incredibly volatile but by June 2008 it had increased fifty-four times. Measured in gold it had merely doubled. Therefore, macroeconomists have a case to answer about the suitability of their dollar currency replacement for gold in its role as a stable medium of exchange.

The next chart shows three major commodity groups, excepting volatile energy which we can take as represented in the first chart above, consolidating a significant number of individual non-seasonal commodities, priced in gold. Since 1992, which is as far back as the IMF's database goes, the average price of these commodities has fallen a net 46%, with considerably less volatility than priced in any fiat currency. The IMF's dollar indices for these three sectors on average rose 2.77 times. Whichever way we look at the relationships

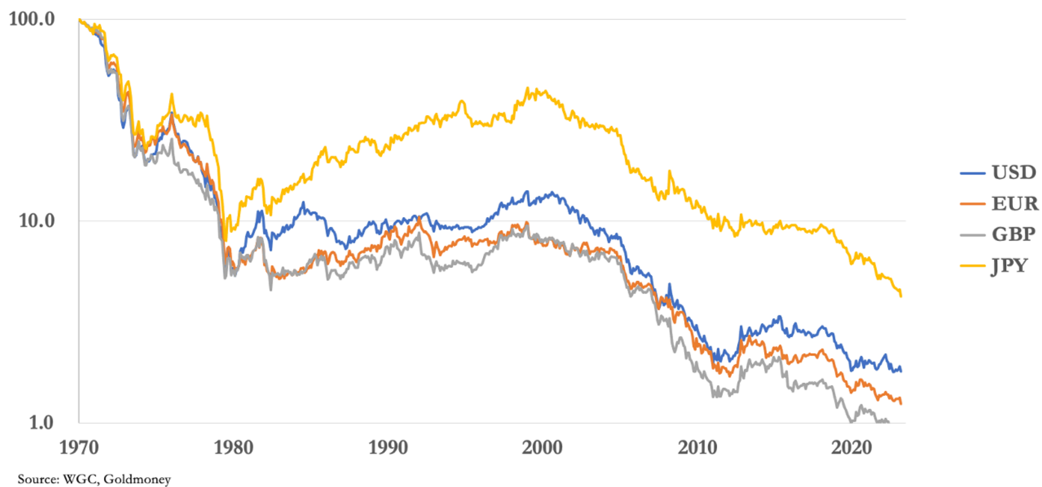
between commodities and mediums of exchange, the evidence is always the same: price volatility is overwhelmingly in the fiat currencies.



Source: IMF, Goldmoney

The only possible conclusions we can draw from the evidence is that detached from gold, fiat currencies are not fit for purpose. Our next chart shows how the four major fiat currencies have performed priced in gold since the permanent suspension of the Bretton Woods agreement in 1971.

Major currencies priced in gold 1970 = 100, Log scale



Since 1970, the US dollar, which establishment economists accept as the de facto replacement for gold, has lost 98.2% of its purchasing power priced in gold (which we have established as still fulfilling the functions of sound money by pricing commodities with minimal variation). The other three major currencies' performance has been similarly abysmal.

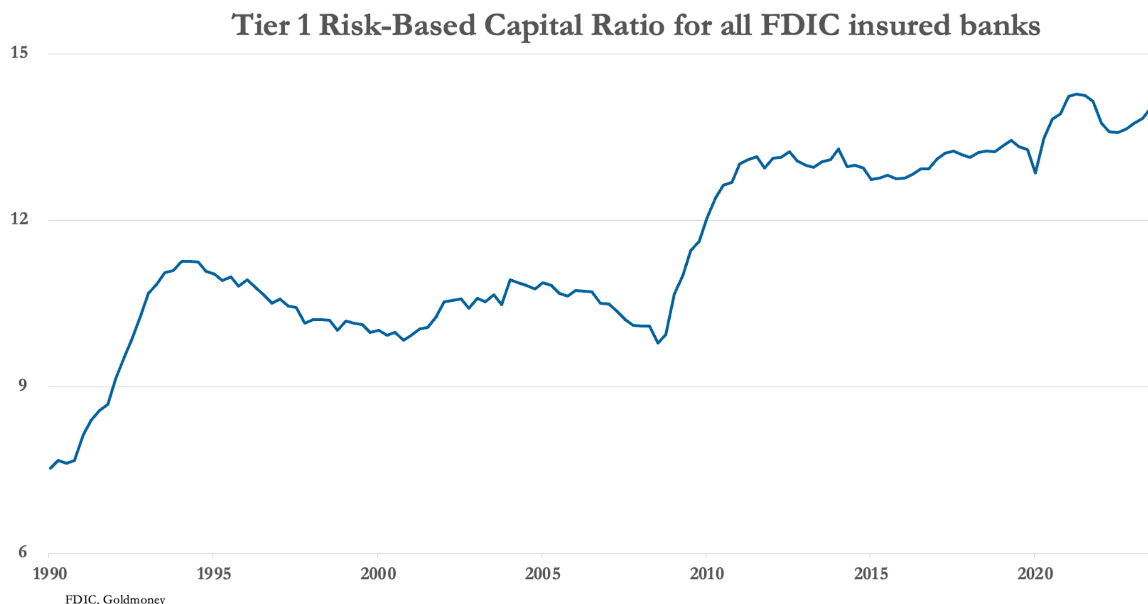
Analysts evaluating the prospects for gold invariably assume, against the evidence, that price variations emanate from gold, and not the currencies detached from legal money. There is little point in following this convention when we know that priced in legal money commodities and therefore the wholesale values of manufactured goods can be expected to change little. The correct approach can only be to examine the outlook for fiat currencies

themselves, and that is what I shall do, concentrating on the US dollar, from which other fiat currencies ultimately take their cue.

2024 is likely to expose the US dollar's fragility

We know that the commercial banking system is highly leveraged, measured by the ratio of balance sheet assets to shareholders' equity which is typical of conditions at the top of the bank credit cycle. While interest rates were firmly anchored to the zero bound, lending margins became compressed, and increasing balance sheet leverage was the means by which a bank could maintain profits at the bottom line.

Now that interest rates have risen, the bankers' collective attitude to bank credit levels has altered fundamentally. They are increasingly sensitive to risk exposure, both in financial and non-financial sector lending. Already, losses in bond markets have accumulated both for their customers and for banks themselves. Consequently, they have begun to modify their business models to reduce their exposure to falling asset values in bonds. The urgency with which this policy is being followed is illustrated in the next chart, of the banking cohort's leverage.



At 14 times, it has barely shifted lower from 2021's peak, reflecting the difficulty with which the entire banking cohort has in reducing its collective balance sheet. But what the chart does not show is the shift in lending from sectors deemed to be risky — the sectors which might saddle banks with non-performing loans.

There are two ways a bank can comply with Basel 3 Tier 1 regulations: either by increasing shareholders' capital or de-risking their balance sheets. For most large US banks issuing more stock is deemed too dilutive, so there is increased pressure to reduce lending risk. This is set by the net stable funding ratio (NSFR) introduced in Basel 3, which is the ratio of available stable funding (ASF) to required stable funding (RSF).

The application of ASF rules is designed to ensure the stability of a bank's sources of credit (i.e., the deposit side of the balance sheet). It applies a 50% haircut to large, corporate depositors, whereas retail deposits being deemed a more stable source of funding, only suffer a 5% haircut. This explains why Goldman Sachs and JPMorgan Chase have set up retail

banking arms and have turned away large deposits, which moved to the Fed through its reverse repo facility instead, and is now being invested in short-term US Treasury bills yielding 5.4%.

The RSF applies to a bank's assets, setting the level of ASF apportionment required. To de-risk its balance sheet, a commercial bank must avoid exposure to loan commitments of more than six months, deposits with other financial institutions, loans to non-financial corporates, and loans to retail and small business customers. Physically traded commodities are also penalised, as are derivative exposures which are not specifically offset by another derivative.

Among other things, this explains the credit squeeze on local small and medium-sized businesses, the backbone of the US economy.

The consequences of Basel 3 NSFR rules are likely to see commercial banking move progressively into a riskless stasis, rather than attempt the reduction in balance sheet size which would require deposit contraction. While individual banks can reduce their deposit liabilities by encouraging them to shift to other banks, system-wide balance sheet contraction requires a net reduction of both deposit balances and similar liabilities across the entire banking network. Other than the very limited ability to write off deposit balances against associated non-performing loans, the creation process of deposits which are always the counterpart of bank loans in origin is difficult to reverse unless banks actually fail. It requires the loan creation process to go into reverse, and the entire cohort of economic actors to pay down their loans on a net basis. While some might be able to do so, for the vast majority in a zombified economy it will prove impossible.

Without the continuing expansion of bank credit at lower interest rates, non-performing loans are bound to increase. They can only be written off against bank equity, stripped of goodwill and other items regarded as the property of shareholders, such as unpaid tax credits. For this reason, US money supply comprised overwhelmingly of bank credit has stopped increasing.

Reverse repos have declined this year

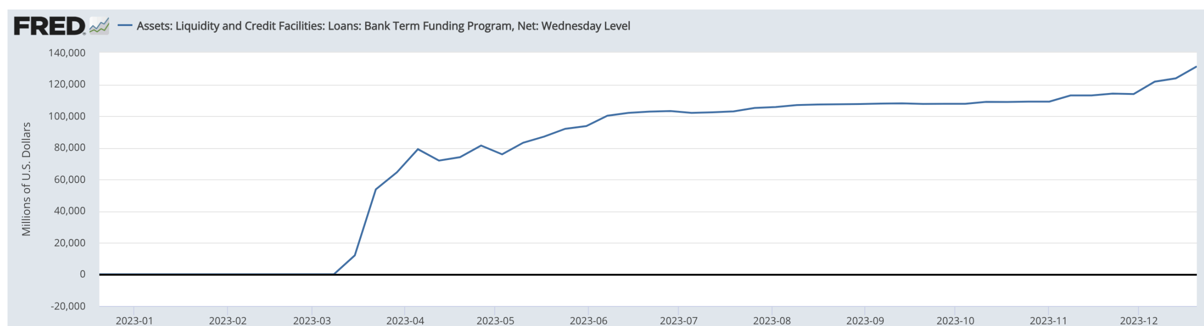
Short of individual banks failing, a reduction in system-wide deposits is therefore difficult to imagine, but banks have been turning away large deposit balances. In 2022, large deposits from money funds were taken up instead by the Fed extending reverse repurchase agreements to non-banking institutions. In a reverse repo, the Fed takes in deposits removing them from public circulation. More to the point, they remove them from the commercial banking system, which is penalised otherwise for exposure to large deposits.

The level of reverse repos at the Fed started to increase following the introduction of Basel 3 regulations and a new rising interest rate trend. In other words, commercial banks began to reject large deposit balances under Basel 3 NSFR rules at the same time as a new set of lending risks began to materialise. Subsequently, money funds have moved to the Treasury bill market instead, reducing the Fed's reverse repo facility from a high of $2.55 trillion at 2022's year-end, amounting to about 12% of M2 money supply at that time. Ahead of this year-end's potential window dressing it stands at $772 billion.

Since mid-October, there has been a substantial decline in Treasury bond yields along the curve, but 6-month T-bills have retained their yields at 5.3%, which explains their attraction to money funds.

With money funds funding the government's general account at the Fed and therefore technically not in public circulation, we have now established one reason why broad money supply is no longer growing. Furthermore, commercial banks are thinly capitalised, and therefore some of them are at risk of insolvency under Tier 1 regulations, which strip out goodwill and other intangibles from shareholders' capital. Working off the FDIC's banking statistics for the entire US banking system at end-2023 Q3, these factors reduce the entire US banking system's true Tier 1 capital from $2,245bn to only $1,448bn, on a total balance sheet of $23,409bn., increasing notional bank leverage to over 16 times.[i]

Shifting on-balance sheet term debt from mark-to-market to holding-to-redemption conceals further losses, as was illustrated by the regional bank failures last March. The reduction in yields along the curve has only taken us back to the levels which triggered Silicon Valley Bank's failure, so the problem for other banks remains. It is not surprising that the Fed had to step in with its bank term funding program (BTFP), allowing bank auditors to value term debt at its redemption value, thereby concealing substantial balance sheet losses. Demand for this facility is still growing, as shown in the St Louis FRED chart below.



Furthermore, with counterparty risks from highly leveraged banking systems in the Eurozone and Japan where asset to equity ratios average more than twenty times, global systemic risk for the large American banks is an additional threat to their survival. The ability of the Fed to ensure that no major bank fails is hampered by its own financial credibility. And given that the only possible escape route from a crisis of bank lending and the US Government's and the Fed's debt traps is accelerating monetary inflation, foreign holders of dollars and dollar-denomicated assets will come under pressure to turn sellers of dollars.

The return to inflationary QE appears inevitable

Anecdotal evidence and business surveys confirm that in common with the other major G7 nations the US is falling into a deepening recession. It is certainly consistent with commercial banks de-risking their balance sheets. For the moment, the US Treasury is the major beneficiary of credit migrating from the private sector, evidenced by the decline of the Fed's reverse repo facility in favour of T-bills. Commercial banks can also be expected to place what little liquidity they have into this market as well.

For the US Government, this is a funding sweet spot, albeit at the highest interest rate along the yield curve. Long-term funding has proved more difficult, as recent bond auctions have illustrated. But the time is approaching when the funding in T-bills becomes less easy, without the Fed increasing its balance sheet. In other words, quantitative tightening is likely to be replaced by quantitative easing.

The injection of raw money from renewed QE is bound to be highly inflationary, as the consequences of last rounds of QE have illustrated, undermining the dollar's purchasing

power more directly than a quantitatively similar credit expansion of commercial bank loans. With respect to bank credit, so long as credit is expanded for productive purposes it is not inflationary. Admittedly, in recent decades bank credit has become increasingly inflationary as consumer lending has increased. But the expansion of credit in order to finance government budget deficits not funded out of increased savings from the private sector is highly inflationary with no material offsets.

In 2024, the budget deficit is set to increase substantially over that of 2023. Excluding interest costs and adjusted for accounting over student loans, the deficit in fiscal 2023 to end-September was a trillion dollars. Interest added a further near-trillion, and that was at an estimated interest cost averaging less than 3% over interest payments, which will also rise significantly given that the debt to be funded, plus the refunding of maturing debt will total over $10 trillion.

When the easy funding through T-bill issuance is exhausted, the question arises as to how a budget deficit likely to be as much as $3 trillion in total will be funded. And this estimate is before the additional welfare costs and lower tax receipts from an economy falling into recession is allowed for. It certainly won't be by the large foreign holders of US Treasuries, who turned sellers in 2023. On the most optimistic scenario, deficit funding can only occur at higher bond yields, or by the Fed aggressively renewing its QE, or both.

Clearly, the US Government is firmly in the grip of a debt trap, from which the only escape is a radical reduction in spending. But that goes against the perceived wisdom that the private sector needs further stimulus to recover, thereby maintaining tax revenues and reducing the welfare burden. This way of thinking is now obviously the road to government bankruptcy, which can only be reflected in an accelerating fall in a fiat currency's purchasing power.

These influences can be summed up as leading to higher rates of inflation at the consumer price level, and therefore higher interest rates instead of the lower rates currently expected by market participants. If the monetary policy makers actually manage to reduce the Fed Funds rate before they are propelled higher will probably depend on whether the dollar continues to weaken materially on the foreign exchanges. It is levels of foreign demand for US dollars and debt instruments which at the margin gives the currency and dependent credit their value.

The foreign exchange's negative vote

A currency's debasement and the adjustment to its purchasing power is realised in two arenas. First and foremost, economists tend to analyse the outcomes on prices in a purely domestic economic context. But almost always, the first realisation of the consequences of credit debasement is by foreign holders of the currency and its underlying investments.

According to the US Treasury TIC system, in October foreigners had dollar bank deposits and short-term securities holdings amounting to $7.328 trillion and a further $24.808 trillion of US long-term securities for a combined total of $32.236 trillion. To this enormous figure can be added Eurodollar balances not recorded in the US Treasury's figures, which according to the Bank for International Securities amounts to an additional $85 trillion.[ii] And eurobonds outside the US monetary system add a further $10 trillion, in all totalling over $127 trillion. These totals do not include exposure to non-financial dollar assets, such as real estate.

These dollar obligations to foreign holders are the consequence of two forces. The first is that the dollar is the world's reserve currency and dollar liquidity is required for global trade. The second is that declining interest rates over the last forty years have encouraged the retention of dollar assets due to rising asset values. As argued above, now that there will be a rising trend of interest rates in future, portfolio accumulations are bound to be reversed. Since May 2021, foreign official holdings of long-term securities (including US Treasuries) have declined by $716bn. The tide against holding US Treasury and Agency debt through rising interest rates is turning.

Furthermore, the US Government chose the worst possible timing for a financial and sanctions war against Russia. By removing all value from Russia's foreign currency reserves, a signal was sent to every other nation that their foreign reserves might could be rendered valueless unless they toe the American line. Together with sanctions, the intention was to cripple Russia's economy. These moves failed completely, a predictable outcome as any informed historian of trade conflicts would have been aware.

Instead, currency sanctions have handed power to Russia because it increased her global influence over non-aligned nations. President Putin has actively encouraged America's creditors to dump dollars and repatriate gold held in financial centres controlled or influenced by partners in the American-led western alliance. More than that, Putin's approach amounts to a declaration of financial conflict against the dollar. The attack on the dollar and the other alliance currencies is being prosecuted by the supra-national organisations through which Russia and China wield their influence.

Other than looking at the dollar overhang from the US Treasury's TIC statistics and BIS estimates, we can judge the forces aligning behind the western alliance and the Russia-China axis in terms of population. Together, the western alliance including the five-eyes security partners, Europe, Japan, and South Korea total 1.2 billion people who by turning their backs on fossil fuels are condemning themselves to de-industrialising. Conversely, the Russia-China axis through the SCO, EAEU, and BRICS directly incorporates about 3.8 billions whose economies are rapidly industrialising. Furthermore, the other 3 billions, mainly on the East Asian fringes, Africa and South America while being broadly neutral are economically dependent to varying degrees on the Russia-China axis. And the Muslim populations in these nations are further antagonised from America and her allies over Gaza.

In terms of trade and finance, the geopolitical tectonic plates have shifted more than is generally realised. Led by America, the alliance is fighting to retain its hegemony on assumptions that might have been valid twenty years ago. But in recent months, we have even seen Saudi Arabia turn its back on America and the petrodollar, along with the entire Middle East. Admittedly, part of the reason for the petrodollar's decline must be the western alliance's policies on fossil fuels. It is due to cut Saudi Arabia off from Western markets entirely in the next few decades. Contrast that with China, happy to sign a gas supply agreement with Qatar for the next 27 years, and the welcome Mohammed bin Salman, Saudi Arabia's de facto leader gave to President Xi earlier a year ago. In return for guaranteed oil supplies, China will recycle substantial investment into Saudi Arabia and the Gulf region, linking it into the Silk Roads and an industrialising pan-Asian economy.

The Saudis are turning their backs not only on oil trade with the western alliance but on their currencies as well. Instead, they will accumulate trade balances with China in yuan and

bring business to the International Shanghai Gold Exchange, even accumulating bullion in exchange for at least some of their net trade surplus.

The consequences of conflicts in Ukraine and Gaza

This year has seen the proxy war in Ukraine grind to a stalemate, with the NATO backed Ukrainians failing to make meaningful gains in the eastern oblasts. The cost in terms of human life have become unsupportable, and according to veteran journalist, Seymour Hersh who broke the true story about the destruction of the Nord stream pipeline sabotage, the commander in chief for the Ukrainian Army, Valery Zaluzhny, is discussing how to end the conflict with his opposite number, Valery Gerasimov, chief of the general Staff of Russia's military. These negotiations are thought to have the backing of President Putin, who it is believed insists on Russian dominated eastern territory being ceded but won't insist on Ukraine not joining NATO, so long as only defensive weapons are deployed on Ukrainian territory. If so, Putin must view NATO as a busted flush.

Neither NATO nor Zelensky are involved, and Zelensky looks to be doubling down with a new army recruitment drive instead. Essentially, there is an army coup in progress, with the army now setting the political agenda. And while America and NATO members probably now want to back out of the Ukrainian conflict, they have yet to find a face-saving way of doing so. Being totally excluded from the peace talks is a direct attack on their status.

The Biden administration will find itself bookended by two policy failures: the first being the hasty departure from Afghanistan and now Ukraine. In the last three years, foreign policy failures in Eurasia and the Middle East have turned from previous pyrrhic victories to outright defeats. And now the Israelis are finding that with America they are aligned with a loser.

With everything military having gone wrong for the American hegemon, its reluctance to get overtly involved in the Gaza situation is understandable. Attempts at brokering peace between Hamas and Israel have been a dead duck. Designating Hamas a terrorist organisation has alienated the Muslim world of two billion people, many living in western alliance lands. It has made enemies of the entire middle east, uniting religious factions.

Now that the G7 nations are so obviously losing hegemonic power, the global south comprised of virtually every non-aligned nation taking the Sino-Russian salt observes the failures and sees the dollar losing more credibility. They see enormous opportunities for themselves, freed from American imperialism. From selling their commodities to the West for pittances, many are now planning to capture more of the value chain from raw materials to final values. China, whose economy is evolving more rapidly than we in the West commonly believe, needs access to cheap commodities less and less as her economic model evolves from exporter of cheap goods to America and Europe to a combination of global infrastructure development and a technology-driven future .

China's renminbi (yuan) policy

While Putin took a leaf out of the American book by insisting on payment for oil from Europe in roubles in order to protect its purchasing power in response to sanctions, less obviously China has agreed a similar policy with Saudi Arabia. Instead of dollars, it will be renminbi, or "petro-yuan". Payments to the Saudis and other members of the Gulf Cooperation Council for oil and gas supplies will be through China's state-owned banks,

which will create the credit necessary for China and other affiliated nations importing energy to pay the Saudis. Through double-entry bookkeeping, the credit will accumulate at the banks in the form of deposits in favour of the exporters, which will in turn be reflected in the energy exporters' currency reserves, replacing dollars which will no longer be needed.

Through its banks, China can create further credit to invest in infrastructure projects in the Middle East, Greater Asia, Africa, and South America. This is precisely what the US did after the agreement with the Saudis back in 1973, leading to the creation of the petrodollar. The difference is that the US used this mechanism to buy off regimes, principally in Latin and South America, so that they would not align with the USSR.

We can expect China to follow a commercial, rather than a political strategy. Bear in mind that both China and Russian foreign policies are to not interfere in the domestic politics of other nations but to pursue their own national interests. Therefore, the expansion of Chinese bank credit will accelerate the industrialisation of Greater Asia for the overall benefit of China's economy. So long as the purchasing power of the yuan is stabilised, this petro-yuan policy should not only succeed, but generate reserve and commercial demand for the yuan. It was the policy that led to the dollar's own stabilisation. With the yuan prospectively replacing the US dollar, we can see that the dollar's hegemony will also be replaced with that of the yuan.

Given the initial disruption to global foreign exchanges as the dollar loses its status, there would be sense in China declaring a gold standard sooner rather than later. Gold retains a stable purchasing power over the long term with only modest fluctuations, the characteristics the Chinese planners are bound to want to see in their currency as the transacting and financing medium for its pan-Asian plans.

In this scenario the US Government and the Fed will be faced with a collapsing currency, which can only be stabilised by going back onto a gold standard. But this goes so against ingrained US policy, a move back to securing the dollar's purchasing power is barely a last resort option.

Finally, some comments on gold

From the foregoing analysis, it should be clear that in estimating the outlook for gold it is not a question of forecasting what the gold price will be in 2023, but what will happen to the dollar, and therefore the other major fiat currencies. These currencies have shown themselves not fit to be mediums of exchange, only being fund-raising media for G7 governments.

While western market analysts appear to have failed to grasp this point, President Putin certainly has. It was Russia that wanted to put gold on the BRICS agenda, proposed as a medium for trade settlement. Presumably, instead of importers and exporters having to use the dollar as the conversion medium between two currencies, Russia was going to develop gold in its place. This would have meant that demand for physical gold would have soared, further undermining fiat currencies — a price for which other nations without sufficient gold reserves was not prepared to pay just yet. But Russia becomes president of BRICS from 1 January.

If he follows through on his anti-dollar comments with action, Putin has the potential to inflict serious damage on the dollar and the other western alliance currencies. Furthermore,

China has also made a major step forward in her agreement with Saudi Arabia to replace the petrodollar with a petro-yuan.

Throughout history, gold, which is legal money, has maintained its value in general terms with only modest variation. It is fiat currencies which have lost purchasing power to the point where from 1970 the dollar has lost over 98% of it. The comparison between gold and the dollar is simply between legal money and fiat credit — the only way in which relative values can be determined between them.

Our last chart will not be a technical presentation of gold, but of the dollar, for which we will use a log scale so that we can think in terms of percentages. Watch for the break below the current support line at about 2%.

The modest fall projected by the arrowed line, if and when it gets to 1 on the chart, is a halving of the dollar's purchasing power, measured in real money, which suggests a gold price for the dollar at 1/3,500 gold ounces. This is not a forecast but gently chides those who think it is the gold price which changes. Where the rate actually settles in 2024 will probably depend on President Putin, who takes the BRICS chair next week and will probably put gold back on the agenda. More than any technical analyst, more than any western investment strategist, and even more than the Fed itself this has the power to set the dollar's future price measured in gold.

One thing we will admit, and that is when fiat currencies begin to slide to the point where domestic Americans realise that it is the dollar falling and not gold rising, a premium will develop for gold's real value, fully reflecting the awful damage a currency collapse does to the collective wealth of a nation.

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[i] See FDIC's QBP Time series balance Sheets.

[ii] See *Dollar debt in FX swaps and forwards: huge, missing, and growing.* By Claudio Borio et al. https://www.bis.org/publ/qtrpdf/r_qt2212h.htm