Collapse Is Happening Before Our Eyes

Description

Analysts and authors, myself included, have been warning about the collapse of the dollar as the global reserve currency for years. I described this prospect in my first book, ***Currency Wars*** (2011), and in several other books in the years since.

This process can take many years. For example, the decline of sterling as the leading global reserve currency played out over 30 years from 1914 (the beginning of World War I) to 1944 (the Bretton Woods conference).

Still, events today are playing out so quickly that the collapse is happening in front of our eyes.

It's no longer a matter of a major event on the horizon; it's occurring in real-time. Russia has just linked the ruble to gold at a rate of 5,000 rubles to one gram of gold. China is discussing with Saudi Arabia the prospect of paying for oil in yuan.

Israel is likewise considering taking yuan in exchange for its high-tech exports. China and Russia are creating new payments systems to avoid U.S. sanctions. You get the point.

Foreign Central Banks Aren't Dumb

Central banks have been net buyers of physical gold since 2010. Countries all over the world are considering dumping dollars for fear that they will be next on the list to have their dollar assets frozen or seized the way the U.S. seized the dollar-denominated assets of the Central Bank of Russia.

That makes sense. What's the point of holding dollars in your reserve positions if the U.S. can freeze those accounts on a whim? Americans tend to take dollar strength for granted, but that's a mistake. It's helpful at times like this to get a foreign perspective.

The U.S. uses the dollar strategically to reward friends and punish enemies. The use of the dollar as a weapon is not limited to trade wars and currency wars, although the dollar is used tactically in those disputes. The dollar is much more powerful than that.

The dollar can be used for regime change by creating hyperinflation, bank runs and domestic dissent in countries targeted by the U.S. The U.S. can depose the governments of its adversaries or at least blunt their policies without firing a shot.

U.S. financial sanctions are a kind of weaponization of the dollar, which can be turned on any country, not just Russia.

The Oldest Form of Money

As of now, there is no single global currency that's in a good position to replace the dollar as the leading reserve currency. But there is one monetary asset that could replace the dollar in reserve positions, although it's not one issued by a central bank.

That asset is gold.

Gold is the oldest form of money. The use of gold is the ideal way to avoid U.S. financial warfare. Gold is physical so it cannot be hacked. It is completely fungible (an element, atomic number 79) so it cannot be traced. Gold can be transported in sealed containers on airplanes so movements cannot be identified through wire transfer message traffic or satellite surveillance.

The world's central banks and finance ministries will soon reach that same conclusion if they haven't already. In this state of affairs, the best financial protection is to acquire some physical gold yourself — while there's still enough physical supply.

But wait, hasn't gold gotten hammered lately?

Yes, gold has suffered one of its periodic beatdowns in recent weeks. Gold was $1,986 per ounce at the close on April 19, and today it's trading at $1,867.

When you widen the aperture slightly, gold was $2,043 per ounce on March 8, not far from its all-time high. So that's a substantial decline over a short period.

It's Not Gold That's Volatile

But gold is volatile. I should say that the gold *market* is volatile. That's because most of it is paper gold, with only a small amount of physical gold to support it.

Think of the gold market as an inverted pyramid, with a small amount of gold at the bottom, holding up a huge amount of paper gold. The paper market could be 100 times the size of the physical market.

That means there are 100 paper claims upon each ounce of physical gold. Imagine a coat check at a restaurant issuing 100 claims for one actual jacket. Well, there's only one coat so 99 claimants are out of luck.

It’s the same in the gold market.

It’s the paper market that creates the volatility. Gold itself is remarkably stable. It only appears unstable because its price is quoted in dollars, which fluctuates. When gold goes down, it’s really because the dollar is going up. When gold goes up, it’s really because the dollar is going down.

A Rigged System

And the paper market is highly vulnerable to price manipulation. Gold manipulation can be done by market players like hedge funds and other major players using ETFs and leasing and unallocated contracts. These manipulations do exist and can influence the price of gold in the short term.

The price of gold is a struggle akin to a tug-of-war between physical and paper transactions.

The price of gold will move, in part, because of manipulators’ actions. There’s very strong mathematical evidence that the gold market is manipulated to suppress prices.

How do they do it?

The easiest way to perform paper manipulation is through rigging the futures market. Rigging futures markets is child’s play. You just wait until a little bit before the close of trading and put in a massive sell order.

By doing this you scare the other side of the market into lowering their bid price; they back away. That lower price then gets trumpeted around the world as the “price” of gold, discouraging investors and hurting sentiment.

The price decline spooks hedge funds into dumping more gold as they hit “stop-loss” limits on their positions. A self-fulfilling momentum is established where selling begets more selling and the price spirals down for no particular reason except that someone wanted it that way.

Eventually a bottom is established and buyers step in, but by then the damage is done.

If you want more details on this topic, please see my book *The New Case for Gold*. Specifically, read Chapter 4, “Gold Is Constant.”

Take the Long View

But the shrewd gold investor takes the long view. That’s how patient investors preserve wealth in the gold market. For those who flit in and out and occasionally buy rallies and sell dips in panic mode, all I can say is good luck. You’re probably going to get crushed.

My advice to investors is that when you have gold, you should think about the quantity of gold by *weight,* not dollar price. Don’t get too hung up on the dollar price, because the dollar could collapse quickly and then the dollar price wouldn’t matter. What would matter is how much physical gold you have.

The goal is to preserve wealth for the long run.

Regards,

Jim Rickards
for *The Daily Reckoning*

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