Easing at the Zero Bound: Beyond QE & the “Foolproof Way”

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Origins of a Currency War, The “Foolproof Way” to Ease Monetary Drivers of Fed Policy

Monetary Analysis

\[ P \cdot Q = \text{Nominal GDP} \]
\[ Q = \text{Real GDP} \]
\[ P = \text{Inflation/Deflation} \]
\[ M = \text{Money supply} \]
\[ V = \text{Velocity of money} \]

\[ M \cdot V = P \cdot Q \]
Fed Expansion of U.S. Money Supply

Board of Governors Monetary Base, Adjusted for Changes in Reserve Requirements (BOGAMBNS)
Source: Board of Governors of the Federal Reserve System

Shaded areas indicate US recessions.
2012 research.stlouisfed.org

QE1
QE2
Velocity of Money Both Volatile and Declining Sharply

Velocity is collapsing

Velocity of M1 Money Stock (M1V)
Source: Federal Reserve Bank of St. Louis

Shaded areas indicate US recessions.
2012 research.stlouisfed.org
Fed Must Bend the Velocity Curve

Changing Velocity is a Socio-Psychological Task

Primary Tools are:

Negative Real Interest Rates
e.g. Nominal Rates of 2% and Inflation of 4% = Real Interest Rate of -2%

Inflation Expectations Shock
e.g. Expectations of 2% inflation and actual inflation of 4% causes an inflationary shock

Both Tools Require 4% Inflation
How Does Fed Achieve 4% Inflation?

- ✔ Cutting Interest Rates (2007)
- ✔ Quantitative Easing (2008)
- ✔ Communications Policy (2008)
- ✔ Currency Wars (2010)
- ✔ Operation Twist (2011)
- ✔ Nominal GDP Targets (2012)
- ✔ Try Harder (2013)
Monetary Math is Easy!

1 + 4 = 5

4 + 1 = 5

Nominal debt requires nominal GDP growth
The G4 Solution to Currency Wars – U.S., UK, Japan, Europe Ease Together
The Year of the Snake Redux

Problems: Europe, Emerging Markets, Inflation
What Could Possibly Go Wrong?
Fed misapprehends the statistical properties of risk in currency and capital markets.

Evidence for complexity and non-equilibrium states is convincing.
Are Capital Markets Complex Systems?

- Diversity
- Connectedness
- Interaction
- Adaptability
How Connected are we? How close to the Critical State?

1. Map of links between companies in 5 key economic sectors: technology (blue), oil (dark grey), other basic materials (light grey), finance linked to real estate (dark green) and other finance (light green). In 2003 the sectors are relatively distinct with real estate isolated; by 2008 they are tightly linked with finance at the centre.

Source: Professor Eve Mitleton-Kelly, London School of Economics. Used with permission.
Interconnectivity of Financial Institutions, Insurers and Other Entities

Caveat: Relative size and density shown on a net rather than gross basis

The Future of the International Monetary System

Multiple Reserve Currencies

Gold

SDR’s

Collapse
A World of Multiple Reserve Currencies

- Reprises 1920’s and 1930’s per Barry Eichengreen
- U.S. Dollar Declined from 70% to 60% of Global Reserves between 2000 and 2012
- Future Reserve Mix could be 35% USD, 35% EUR, 10% JPY, 20% GBP, CNY, CHF, CAD, AUD, other
- Dynamically unstable without an anchor
- Solves no problems, creates new one
The SDR Solution

- Obviated in 1980's by commercial banks
- Preferred path of the power elites
- Ten-year plan includes issuers, buyers, dealers, repo, derivatives and new allocations
- SDR's will not be local currency, but used for oil, global corporations, balance of payments
- Turns IMF into proto-world central bank with currency and expanded balance sheet
A New Gold Standard

- What is a Gold Standard?
- What is the proper measure of Money?
- What is the proper reserve ratio?
- Which nations are included?
Official Gold Holdings - Total 30,731 Metric Tonnes

- United States: 8,133 Metric Tonnes
- Germany: 3,406 Metric Tonnes
- IMF: 2,966 Metric Tonnes
- Italy: 2,451 Metric Tonnes
- France: 2,435 Metric Tonnes
- China: 1,054 Metric Tonnes
- Switzerland: 1,040 Metric Tonnes
- Russia: 937 Metric Tonnes
- Japan: 765 Metric Tonnes
- All Others: 7,544 Metric Tonnes

Metric Tonnes
Holdings with Eurosystem - Total 30,731 Metric Tonnes

- Eurosystem: 10,798
- United States: 8,133
- IMF: 2,966
- China: 1,054
- Switzerland: 1,040
- Russia: 937
- Japan: 765
- India: 557
- Taiwan: 423
- All Others: 5,098
Gold Prices Based on Global Monetary Aggregates (US, ECB, China)

USD per Ounce of Gold

- GM1 (.40): $6,993
- GM1: $17,482
- GM2 (.40): $17,820
- GM2: $44,552
What Happens When Gold is the Numeraire?

The S&P500 Index in Gold Ounces
Collapse
Thriving in a world of inflation, currency wars and potential collapse

Long

Banco Santander (ADR) (NYSE:SAN) – On Euro, TBTF, LatAM
Bank of Ireland (ADR) (NYSE:IRE) – On Euro, TBTF
Gold – Physical or non-bank fund will allocated bars
Fine Art – Twentieth Century Masters Collection – Sandy Kemper
Currencies: EUR, SGD, AUD, CAD, KRW

Short

JPMorgan Chase & Co (NYSE:JPM) – Poor risk management
Currencies: USD, GBP, JPY, BRL
Thank you

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