Growing concerns over stability of the international monetary system

By Nick Beams
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There are growing concerns, at least in some financial circles, that the monetary policies presently being pursued by the US Fed and the world's other major central banks could, at some point, result in a crisis of confidence in "fiat" currencies issued by the state and lead to a turn to gold as a store of value.

These fears were voiced in an article by the incoming editor of the *Financial Times,* Rana Foroohar, published on Monday under the headline, "Gold is looking more and more attractive."

"Gold bugs have always struck me as paranoid," she wrote. "You really have to believe the sky is falling in order to horde physical bars in a digital age. So it's rather worrying that some investors and central bankers are talking up gold."

Foroohar cited a recent article by the central bank of the Netherlands that pointed to the role of gold if a crisis of confidence emerged in the monetary system. The article stated that "if the system collapses, the gold stock can serve as a basis to build it up again." It added, "Gold bolsters confidence in the central bank's balance sheet and creates a sense of security."

The concerns over a possible crisis of the monetary system are being fuelled by the experiences of the past decade of monetary policy. The unprecedented pumping of trillions of dollars into the global financial system by the major central banks has failed to bring about any genuine recovery in global economic growth.

In response to the financial crash of 2008, the Fed, along with other major central banks, bailed out the banks to the tune of hundreds of billions of dollars and cut interest rates to historic lows. When these policies failed, they embarked on unconventional monetary policies based on the purchase of financial assets, so-called "quantitative easing."

The holdings of such assets by the Fed expanded from around $800 billion before the crash to more than $4 trillion. The European Central Bank's program has resulted in it holding some €2.6 trillion worth of financial assets. Nothing like this has ever been seen before in history.

The major effect of these measures has been to send the price of financial assets such as stocks and bonds soaring, increasing the wealth of corporations and the global financial elites by trillions of dollars, and accelerating the growth of social inequality around the world as wages stagnate and social spending is cut on the grounds that "there is no money."

The rationale advanced in support of these measures was that they were necessary to prevent a complete collapse of the financial system, and that they would eventually lead to a return to growth in the real economy, making it possible to revert to a "normal" monetary policy.

In 2017 and early 2018 it appeared finally that this might be the case as global growth rates started to rise, reaching their highest levels since the period immediately before the financial crisis. Accordingly, the Fed began to raise rates—there were four increases of 0.25 percentage points each in 2018—and it started to wind down its holdings of financial assets. The European Central Bank (ECB) followed suit and also halted its asset purchases, while still keeping its base interest rate in negative territory.

The Bank of Japan, however, did not follow this course, but kept its base interest rate at zero and maintained its purchases of government bonds and other financial assets, to the extent that it now holds 46 percent of government debt. In the Japanese market for government bonds, one arm of the state, the government, is the seller of debt, while another arm, the Bank of Japan, is the purchaser. Now there are fears that the entire world may be on the road to "Japanification."

The move to "normalisation" by the Fed and the ECB has been very short-lived. At the end of last year, the rapid fall in US equity markets saw the Fed do an about-turn. In the first half of this year it maintained it would not raise rates. It also indicated that the reduction of its asset holdings—a policy described at one point by Fed Chairman Jerome Powell as being on "auto pilot"—was to be ended even before it had really gotten underway.

This was followed by three interest rate cuts of 0.25 percentage points each since July, together with the message, under the Fed's policy of so-called "forward guidance" to financial markets, that rises were off the table for the foreseeable future. Wall Street has duly celebrated by pushing stock market indexes to new record highs.

The ECB has followed suit, resuming its program of asset purchases and pushing its base interest rate further into negative territory.

The failure of both interest rate cuts and quantitative easing to bring about any real expansion of the global economy—the International Monetary Fund has said the world economy is in a synchronised global slowdown characterised by falling investment in the major economies and a contraction in trade—has raised questions about the next stage of monetary policy.

In her article, Foroohar cited remarks by Ray Dalio, the chief of the Bridgewater hedge fund, one of the world's largest, to a conference convened by the Institute for International Finance (IIF) last month. Dalio said that in order to continue paying its bills, the US Federal Reserve would have to inflate its balance sheet and keep interest rates low or even negative. This could lead to a situation where nobody would want to own US debt and investors would look for other assets as a store of value.

"The question is, what else?" he asked. "That's the environment I think we'll be in. And there's a saying that gold is the only asset you can have that's not somebody else's liability."

Foroohar also pointed to a recent newsletter by financial analyst Luke Gromen, regarded in some circles as a "gold bug," in which he noted that annual US "entitlements"—defined as payments on Medicare, Medicaid and Social Security plus defence spending and interest payments—now stand at 112 percent of US federal tax receipts. This has risen from 103 percent 15 months ago and 95 percent two years ago—a rise brought about by Trump's tax cuts for corporations and the wealthy.

Gromen wrote that the US has become "utterly dependent on asset price inflation for tax receipts" and the only way the government could pay its bills was for asset prices to rise on their own or for the Fed to "print enough money to make asset prices rise."

In remarks to the IIF conference, not reported by Foroohar, Dalio raised questions about the future of the fiat monetary system, where what is money is determined by the state.

He said that "we are in a new world now," a seemingly "crazy," "odd" or "other reality," in which central banks will have to increasingly "monetize" debt, along the lines of what is already taking place in Japan, in order for government payments as well as payouts by pension funds to be met.

"I think we are in the last stages or the end of the last stages of what is currency, what is reserve currency, how does that fiat currency system work," he said.

It is not possible to predict exactly how this new financial world—a world of negative interest rates and the monetization of mounting debt by central banks—will develop. But it is clear that the very foundations of the system of international finance are coming under increasing strain, with the prospect of a collapse with devastating economic consequences looming ever larger.

The prospect that such a crisis may provoke a return to gold as the only basis for a store of value, as confidence in fiat currencies erodes, raises fundamental issues elaborated by Marx in his analysis of the contradictions and crises of the capitalist economy.

Marx advanced what has been termed a commodity theory of money: that, ultimately, value had to have a material form of expression in another commodity, which, for historical reasons, was gold. Capitalism, he maintained, strove to overcome this metal barrier through the development of credit and other mechanisms, but "again and again breaks its back on this barrier."

Following the removal of the gold backing from the US dollar by President Nixon in August 1971, it was held by many economists, including some who called themselves Marxists, that Marx's analysis was invalid. The expansion of the global economy, in which a fiat currency, the US dollar, no longer backed by gold, functioned as the foundation of the international monetary system, was a historical refutation of his analysis, it was claimed.

However, under conditions of increasing international financial turmoil and growing doubts about the stability of the fiat currency system, another remark made by Marx should also be recalled. He noted that the fundamental laws of political economy do not assert themselves gradually or smoothly, but express themselves like the law of gravity when a house falls about our ears. And as the concerns voiced by the editor of the *Financial Times* and others make clear, the house of international finance is starting to shake.