

## **Spreading the Risk**

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The sovereign debt crisis in Europe has caused leaders there to adopt a new collective policy that would link members under a strict fiscal structure which may be called the European Fiscal Union. Like the European Monetary Union, which established the Euro as the common currency, the EFU would establish common liability for member state fiscal conditions. Under the terms of a new EU treaty, each member state would be required to meet debt/GDP ratio limits and other financial stress tests in order to access bailout funds provided by a larger European Financial Stability Fund. Using leverage, the EFSF could grow to 1 Trillion Euro. The IMF and the ECB are additional sources of bailout capital, although the ECB has been hesitant to lend to failing countries without other collateral or backing.

As of Friday, 27 nations pledged to join the new treaty arrangement. The United Kingdom has declined to participate in the wider fiscal union.

Initially, the developments across the pond were good news for the markets. The Dow rallied nearly 200 points Friday, and the Euro gained against the Dollar. Gold and silver benefitted as well Friday, but are giving up gains as the markets slump in early trading today.

But the devil is in the details. All 17 nations that use the Euro agreed to sign a treaty that allows a central European authority closer oversight of their budgets. Nine other EU nations are considering it. A new treaty could take three months to negotiate and may require referendums in countries such as Ireland. While the nine non-euro-zone countries said they would join the new fiscal union, there were quickly notes of caution from some corners, including the Czech Republic and Hungary.

Meanwhile the debt bombs in Italy and Spain are ticking. Active ECB support will be vital in the coming days with markets doubting the strength of Europe's financial firewalls to protect vulnerable economies such as Italy and Spain, which have to roll over hundreds of billions of Euros in debt next year. European leaders did agree to loan the International Monetary Fund €200 billion (\$267.7 billion) to help struggling euro-zone countries and launch a €500 billion European Stability Mechanism by July 2012. The ECB has yet to commit more than 20 billion Euros to failing clients at any one time, and is reluctant to risk the much larger transactions required to stabilize debt-heavy governments. One reason is that ECB funding may be a disincentive for countries to follow through with austerity measures. Free money is easy to spend, and given the chance, governments usually do.

Without access to new funding under tight fiscal controls, Europe may slip once again into a deep recession, which would hurt US economic growth as well. The stakes are high for Europe to get it right quickly.

So we can expect the markets to remain highly volatile as events unfold in Europe. Today's market action, for example shows gold and the Euro are under pressure. The price of gold is telling us the grand EU fiscal cannon is too small to succeed. Investors are choosing to sell their risk holdings in favor of cash. Some investors are turning to gold as a source of capital, in some cases to meet margin calls. Gold has been the only asset class that has performed with double digit gains this year while stocks and other commodities have barely kept above water.

And it's not just investors that are skeptical. Standard & Poor's reiterated its warning that downgrades of Eurozone nations are a possibility while Moody's Investors Service said the new fiscal agreement offered "few new measures" and it still expects to reassess its credit ratings of the European sovereigns.

Europe is not the only economy facing a debt crisis and possibly another recession. We need only to observe our own policymakers to see what lies ahead.

### **Federal Reserve Policy**

The Federal Reserve meets Tuesday for its regular two-day Federal Open Market Committee (FOMC) meeting. That means Wednesday we will hear from Chairman Ben on the latest status and outlook of the US economy. There has been some talk that the Fed is considering reviving the practice of publicizing its internal projections of interest rate and inflation forecasts in an effort to better "communicate" to the public. The Fed dropped this practice in 2007 because it was considered largely ineffective. And besides, it proved once again that, as Yogi observed, "Predictions are hard, especially about the future."

Expectations are that the Fed will continue to keep interest rates at 0.0 - .25%, and despite some calls for additional stimulus, no new massive bond buying will be initiated—just yet. Chicago Fed president Charlie Evans is calling for more stimulus now. "There is simply too much at stake for us to be excessively complacent while the economy is in such dire shape," Evans said in his December 5th speech in Muncie, Indiana. "It is imperative to undertake action now."

Chairman Ben has come to realize that the US remains in a liquidity trap, that helpless condition wherein injecting additional cash into the money supply has no positive effect on GDP growth. Even Paul Krugman knows that interest rates simply cannot get lower than zero.

Notwithstanding, QE3 would go a long way to boost Wall Street. And we have heard some preparatory statements from some Fed governors on the merits of additional quantitative easing, as long as inflation remains "in check".

Would that the Chairman realize that economic prosperity does not stem from monetary intervention.

We know now that Federal Reserve policy has failed. Massive intervention has resulted in higher prices, growing inflation and persistent unemployment near Great Depression levels. The Dollar buys less and less. Real wages are declining. Government data show over the past decade, real private-sector wage growth has bottomed at 4%, just below the 5% increase from 1929 to 1939.

Economic recovery requires real wage growth. More disposable income helps create demand for goods and services. Increased demand causes businesses to expand, which means more production and usually more employment.

But that simple calculus is lost on the central planners. Instead, Washington believes that government spending creates demand. But government spends the tax dollars it first takes out of the economy in order to distribute funds to “better uses”. Robbing Peter to pay Paul.

What we need is fundamental change. This will only come when the majority of citizens realize that Keynesian economics is not the path to prosperity and that the principles of free markets, private property and sound money should and by right, ought to be embraced.

Until then, one must rely on individual choice to guard against oppressive monetary policy. Sound money is the answer.

Investors from around the world benefit from timely market analysis on gold and silver and portfolio recommendations contained in *The Gold Speculator* investment newsletter, which is based on the principles of free markets, private property, sound money and Austrian School economics.

The question for you to consider is how are you going to protect yourself from the vagaries of the fiat money and economic uncertainty? We publish *The Gold Speculator* to help people make better decisions about their money. Our Model Conservative Portfolio gained 66.7% in 2010, and 55% for 1Q2011. Subscribe at our web site [www.thegoldspeculatorllc.com](http://www.thegoldspeculatorllc.com) with credit card or PayPal (\$300/yr) or by sending your check for \$290 (\$10 cash discount) The Gold Speculator, 614 Nashua St. #142 Milford, NH 03055