INDEPENDENT TRADER NEWSLETTER

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In today's edition:

The Power of the Sino-Russian Alliance.

The XXth century was an example of the unequivocal dominance of the USA. For the last 100 years, many countries tried to liberate themselves from the auspices of the US. They were losing either financially or militarily. What we know from history is that every empire collapses under its own weight and the United States of America is no exception here.

For years, the US governments patched the system through ever growing surveillance and control both internally and abroad. The empire required more liquidity as it grew more expensive. For this, new strata of society and other nations were given the bill. The emancipation of women was very helpful here. Higher labour participation means more taxes. The petrodollar was created with the cooperation of Saudi Arabia. Right after Nixon resigned from the gold standard in 1971 an artificial demand for the dollar emerged.

Being an empire requires an increasing amount of funds and after Saudis, China was next on the list. None other than Bush senior helped to open isolated, communist economy. The US could now print money to buy cheap production from the East. The consequences of that move are huge.

China, being helped by the US, entered the path which ultimately created a rival. Rival stronger than Japan defeated 20 years ago. After cautiously observing neighbours being attacked financially, China successfully guarded their own market against economic extortion.

Beijing understood that infrastructure or trade development is not enough to take the crown for themselves. To win with the global hegemony you need friends. Friends allowing and helping the development of trade routes and new markets. All this with a hostile stance of the US. Russia was chosen as a natural opponent of the US and Europe, also one of the key trading partner of things 'made in China'.

Washington knew that German-Russian-Chinese alliance combining technology, resources and production capabilities is a deadly concoction. The US is doing everything it can to conflict aforementioned countries aiming to end the status quo. Taking Berlin out of the equation was easy as Germans are woven strongly in the NATO and EU structures. Breaking up the Kremlin-Beijing link was not successful.

Geopolitics in the service of the economy

The key to killing a fast development of China was the Middle-Eastern oil. Russia blocked an attempt to take over Syria by the US and this complicated the plan. To defeat China, Russia must first be aligned to the American cause – a regime must be changed in Kremlin. A difficult task, but as history shows, possible to accomplish. Just like against the USSR – the economy was supposed to be the weapon of choice. Lowering oil price to hurt the budget of which significant share is coming from the sale of hydrocarbons. The same strategy as 30 years ago. The burden of debt also fuels oil price crisis making it even worse than before. While the USSR was dependent on Western credit and technology, today's Russia has evolved. Low public debt at 18% of the GDP, currency reserves worth 387 billion USD gave enough options for Kremlin to still stand fast and diversify revenue streams after the hit.

Apart from crude price, being also cut thanks to the new technology of hydraulic fracturing and Saudi's oversupply, the US tried to utilise sanctions against Russia in connection with the Ukrainian coup. The Ukrainian crisis was aimed at cutting Russia from the access to the Black Sea and Crimean naval base which was leased by Russia from Ukraine. Putin and his imperial ambitions fell into the trap of the West - he annexed Crimea - and sanctions were easy to lobby through.

Russia without access to the Black Sea would face a difficult task of defending Syria and Russian naval base in Tartus. The US forced the EU to introduce sanctions against Russia due to Putin's grab of Ukrainians territory. Soon after ruble experienced heavy losses, Kremlin's credit rating was lowered and the headlines were prophesying the fall of the Russian regime.

Putin has experienced advisors. He kept his cool and did what was nearly impossible task for other leaders to consent to. He let the ruble lose 50% of its purchasing parity vis-à-vis dollar. It was done without the sell-off of the currency reserves. The solution was pretty simple indeed. Putin used anti-Kremlin propaganda to show Russians that they are attacked by rotten neocons who pillage Ukrainian territory and kill true Ukrainians. A patriotic society solidarized with the government.

Without losing public acceptance, public's anti-west attitude was used to let ruble fall by 50%. Another round of currency wars won by Putin. This enabled Moscow to receive more revenues from sold barrels thanks to cheaper currency, lower costs of labour and a big advantage in international trade – all without riots on the streets.

Russia boasting vast natural resources, now could mine, process and use those riches also in its own production. Cheap goods are very competitive and can be exported with success while Moscow with sensible fiscal policy gained time to reorganise and diversify national production.

The US plan to cut Russia from the world failed nonetheless EU sanctions. Russia with BRICS, and especially China's support, is doing just fine. Of course, there are some negative consequences. Selling oil fields to Indian corporations, allowing Chinese capital into the banking sector are news big enough to make it to headlines. Russian currency reserves stocked by the Russian central bank are growing since 2015. Moscow is also investing in gold as one of the top buyers in the world. The public debt increased to 166 bn USD but this amounts to less than half of the official currency reserves.

The Russian economy is well and this makes Kremlin not only defend but actively fight for its interests against the US and its allies in the Middle East. This fight also has an economic dimension. Recently the first Russian rating agency has been established – ACRA. Moscow will soon deliver the equivalent of SWIFT payment system. Bigger trade deals are settled in local currencies instead of USD.

Today, the biggest ally of Russia in the fight against the US is China. Those two countries tighten their economic relations much more than what is shown in the news.

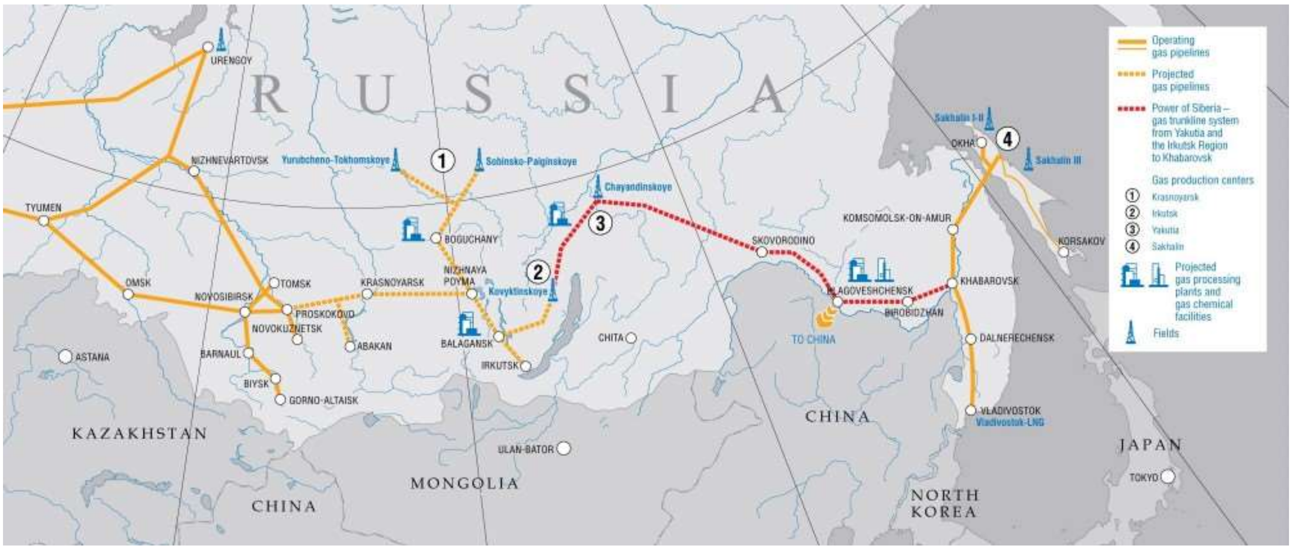
Sino-Russian Cooperation

The importance of cooperation between China and Russia grows due to the common threat and picks up speed as a result of the global recession and Western sanctions. Trade relations are fostered by compatibility of both economies. Russia, a vast country with low population density, rich in natural resources supplies China - a country more production-oriented. Big currency reserves of China is what Russians can envy Beijing as they need it for the economic stabilisation.

Authorities of both countries realised how big of a danger is the US to them. They both understand that alone China and Russia are weak. Collaboration must not stop on export and import but it has to encompass defence, military technologies, education, social integration and foreign policy coordination.

Cooperation is already seen in many sectors: health, energy, military, finance, banking, higher education, IT, electronics, chemical industry, water, agriculture, transport, infrastructure and even space exploration with launching satellites into orbit. To present such complex connection of both countries I will talk about projects which have already started.

Gas – Two big projects: the first one is called the Power of Siberia, the second one is the Altai. Former creates a connection between Vladivostok and China.



Source: defence24.pl

The link will span over 4000 km through which 6.1 bn m3 of gas will flow each year. The deal was signed in 2014 for 30 years.

The Altai pipeline is going to be built in the north part of Siberia. The northern part of Russia will be connected through pipes 2 600 km long with China. After crossing the border fuel can ultimately end up on the east coast of China. Maximum flow of 30 bn m3 each year is worth (in today's prices) 6 bn USD. According to research, before 2020 China may need 300-400 bn m3 each year – potential for development is huge.

TRISH McALASTER / THE GLOBE AND MAIL » SOURCES: GAZPROM, GRAPHIC NEWS

Both projects are enormous and looking at the tense situation in the Middle East, Russian pipelines can be a very good source of diversification of energy resources. What is more, Beijing pre-paid 25 bn USD to help finance the project.

Oil – China gave a loan to Rosneft for the acquisition of TNB, third largest oil production company in Russia, previously controlled by BP. Thanks to capital flow from Asian banks Rosneft became a business partner of China National Petroleum Corporation and they both have plans to cooperate during oil fields exploitation from Crimean region and the Arctic.

Coal – Rostec and Shenhua Group joined their forces to exploit coal from Siberia and the Far East. The operation is worth 10 bn USD and apart from infrastructure itself, the project will build coal power plants. They are going to bring energy not only to Russia and China but the electricity can be sold further to neighbouring Asian countries. Some of the black gold is planned to be transported to Vera sea port and sold further to clients in the Pacific region. It is estimated that amount of coal sold can reach 20 million tonnes per annum.

Nuclear energy – Rosatom is building 4 nuclear power plants in Tianwan. Before Beijing turned to Russians, American Westinghouse was the contractor. The contract contained an obligation to build 26 power plants but dark clouds are gathering due to the political situation. Fuel for power plants seems to be the main problem. Fuel elements of Westinghouse and Rosatom are different. We know from European examples that reactors can work on both but Chinese authorities have now a great pretext to put the project on hold.

Satellites – Both Russia and China have their own GPS - GLONASS and BEIDOU. GLONASS is an older, already tested system and it covers the whole globe. BEIDOU has a limited coverage, lower accuracy and still needs upgrading. Cooperation here gives China global GPS thanks to Moscow building stations on the ground across the Red Dragon's territory. This technology can enable better defence capabilities of Beijing and missile guidance for the counter-engagement system. GPS cooperation does not end with military use – it will also improve air and maritime transport.

Space – Here Russian rocket engines will be produced in Chinese factories. Countries are talking about sharing access to expertise regarding land and space R&D. This is connected to creating an answer for the US doctrine which talks about space as the next stage of the battlefield.

Aircraft industry and military projects – Rostec and Aviation Industry Corp China signed a memorandum of cooperation in the aviation sector. Production and distribution of components, engines, helicopters and planes in Russia, China and other countries. Thanks to synergy heavy helicopter basing on Mi-26 and Chinese equivalent of Airbus will be build.

China is buying 6 battalions of the S400 air defence system for 3 bn USD. The agreement also talks about cooperation during deployment of the S500 systems which is still under development. This system is going to be a part of the anti-air defence of China but also in the future it should protect the New Silk Road.

Russia and China are building a new generation of silent submarines, likes of Amur 1650. They are a part of the MAD program - a weapon used for a nuclear counterattack with payload carried by Bulava ICBM. China can bring to the table MIRVed rockets which can attack many targets at once. Project plans four submarines in total, two for each country.

IT and microelectronics – Russia buys electronic components for their missiles and defence systems from China, an alternative from the US supplier used before. The deal is worth 1 bn USD equal to 50% of imports from the US. Thanks to this program Moscow plans to stop importing any electronic components from across the Pacific.

Technology parks – Both countries want to create two technology parks with the help of Russian Direct Investment Fund and Chinese Investment Corporation. One in Xixian Fendong spanning 4km2, the second one in Moscow in Skolkovo Innovation Center with space of 0.2km2. Both parks will also have their affiliate subdivisions in other cities. Initiative fosters technological exchange between participants.

Cybersecurity – Russia and China want to defend against the CIA and the NSA also in the field of cyberspace. This is another step after signing a Cyber Nonaggression Pact.

Education – In summer this year a program of 100 000 student exchange and internships starts in both countries: Far Eastern Federal University and Beijing University of Technology.

Banking – Russia and China agreed between their central banks on swaps valid since 2014. Thanks to them corporations have more liquidity and trade can be done in other currencies than USD. Apart from central banks also commercial ones opened credit lines in Chinese institutions as a security of liquidity and defence against sanctions on Russia. Additionally, Kremlin allowed acquisitions of few entities in Russian banking sector by Chinese capital.

Credit Cards – China UnionPay, Chinese credit card system replaced Mastercard and Visa in both countries. After sanctions against Russia were fully implemented Kremlin started working on its own – MIR – system.

Automotive industry -– Chinese Great Wall Motors is building one of its factories in Russia. Production is aimed at 150 000 vehicles and should commence in 2017.

Petrochemical industry – In Shanghai, a new factory of rubber is erected thanks to the participation of Sibur and Sinopec. Before both companies built a similar venture in Krasnoyarsk.

Development and infrastructure – Chinese companies started building high-speed rail connecting Moscow and Kazan and later also Beijing. The first link is 770 km long. Trains should achieve up to 400 km/h there. Chinese further develop Moscow's subway, roads and bridges along borders of both countries. On top of that, Putin started a big housing program – 460 000 houses are going to be built by Chinese.

Shanghai Cooperation Organization (SCO) – this is an answer for the threat of colourful revolutions and proxy wars. The SCO is definitely not an Eastern NATO; it is rather a platform for agencies and military information sharing of member states. China and Russia are natural leaders while Kazakhstan, Kirgizstan, Tajikistan, and Uzbekistan. India and Pakistan are already undergoing accession talks. What is interesting is the fact that Turkey is one of the dialogue partner (states sharing similar values and goals with the SCO). After shooting down Russian plane over Syria, relations between those countries are very cold.

Thanks to Sino-Russian cooperation authorities of both countries responsible for economy and military meet very often. What is being said is unknown. Agendas and transcripts are confidential but type and degree of cooperation in military-oriented projects are definitely being consulted. Having a natural opponent of NATO, a subject of defence capabilities has to be paramount for both regional superpowers.

Goal of the Sino-Russian cooperation

First and foremost this collaboration has the political foundation but the economic part is also essential. After being isolated from a share of the European trade revenue Russia is in a bad spot. China due to the attempt to transform their economy from exporting powerhouse to one where consumption drives growth has to advance the relationship with Russia.

China has a great production-consumer base with 1.3 billion people. Question Beijing has to answer is how to transform the Chinese citizen from a saver to a consumer. Low consumption resulted in 1/5 of the world population producing too much. Until 2014 the solution implemented was to acquire foreign government bonds – mostly American – to credit consumption abroad. This process has finished when the issuer's bankruptcy risk increased.

The lion's share of China's production ends up in America or Europe but the economic crisis in both destinations results in a lower demand for Chinese goods. This is the reason to look for alternative markets, like Africa but this is not enough to balance demand that vanished.

Low demand across the ocean makes Chinese corporations fear for their existence. Differentiation of exports is the key to continuing Chinese boom and Russia is a great alternative. It is great but not perfect alternative as Russians don't have enough purchasing power to substitute EU's demand. China understands it very well but aims at solving that problem with many investment projects in Russia.

In 2015 trade between those two countries dropped from 90 bn to 60 bn USD y/y. It is estimated that in the long run it will grow to 200 bn USD per year. The potential is huge but any financial market turmoil makes achieving this goal very hard.

China in the face of crisis

The centrally planned economy reached a dead end. Lower demand makes titanic manufacturing capabilities work far from their maximum efficiency. This, in turn, makes an unemployment surge and social fabric is stretched. People ever more loudly point out that government's policy failed them. This sentiment is a great chance for the US to incite riots, a coup or even a civil war. We all have seen it before.

The oversupply is not the only one problem Chinese authorities have on their plate. I'm thinking about a huge real estate bubble – it may be the biggest bubble of its kind in history. In just three years Asian economy used enough cement to match the amount the US used in the whole XXth century. Properties are expensive and developers do everything not to lower prices. Families of farmers were given flats in newly built skyscrapers after their properties were taken from them to build huge agglomerations. The majority of Chinese don't have that much luck and to buy their own place they have to take a lot of debt on their back.

The debt is a factor that only slows down Chinese society transformation. It is possible that the government will have to restructure the debt of their own citizens especially with the unemployment surging non-stop. This situation puts a strain on the banking sector. For now, the government decided to buy a share of bad debts and to slowly extinguish unprofitable ventures. Unfortunately, when we see the scale of such intervention, deflating a humongous credit bubble cannot be done slowly.

How to solve this problem? A Chinese political hybrid of capitalism and communism may be useful here. The capitalism part is seen in 'lower' sections of the economy. People are free to have their own small businesses, street vending or any other small initiative which is far from vast government actions or development plans. The centrally planned part is everything which is 'big'. The burst of the credit bubble is going to be easier to handle when debts of individuals, corporations, and banks will be arbitrarily written-off. This will give Chinese regime a clean slate to start over with a system backed by the gold standard. It can be possible thanks to enormous amounts of gold, bought right now through the SGE, amounting to annual global production. After the reset, everyone else will be left with worthless paper but China could be proud then of their infrastructure built with (written-off) debt and a lot of gold in their reserves. Of course, after public developers file en masse for bankruptcy there will be riots on the streets but then again we are talking about the top-down approach and the government can satisfy society with free properties they have built years before. The ghost towns will finally find their citizens. This is the big advantage over the Western economies where the state would have to cover losses of bankrupt developers.

The plan presented above is very much possible. The circles of Chinese authorities were joined by people like Hong Song Bing who understand threats and obstacles that led to Japan and other Asian Tigers' failures. China has the upper hand as a result of a surplus gained in international trade all over the world.

If the EU revokes their sanctions against Russia in the future, there would be no match to the powerful Eurasian conglomerate. The business circle of both Russia and China receives hopeful messages from Germany aspiring to join Eastern superpowers. It is hard to tell whether Berlin can emancipate itself from the Washington's control. The gravity from the East is becoming stronger especially after the Western policy was defeated by Russia in the Middle East. Also, the diplomatic dimension is just a series of Obama's failures which is utterly uninspiring.

Poland as the US puppet

Poland is the most important country in the East flank of the NATO. It is situated in a place giving great potential for foreign policy games. The problem here is the negative sentiment towards Russia. Instead of trying and ride both horses, like Turks do to achieve the most efficient result, the Polish government tries to get Western military presence on its own territory.

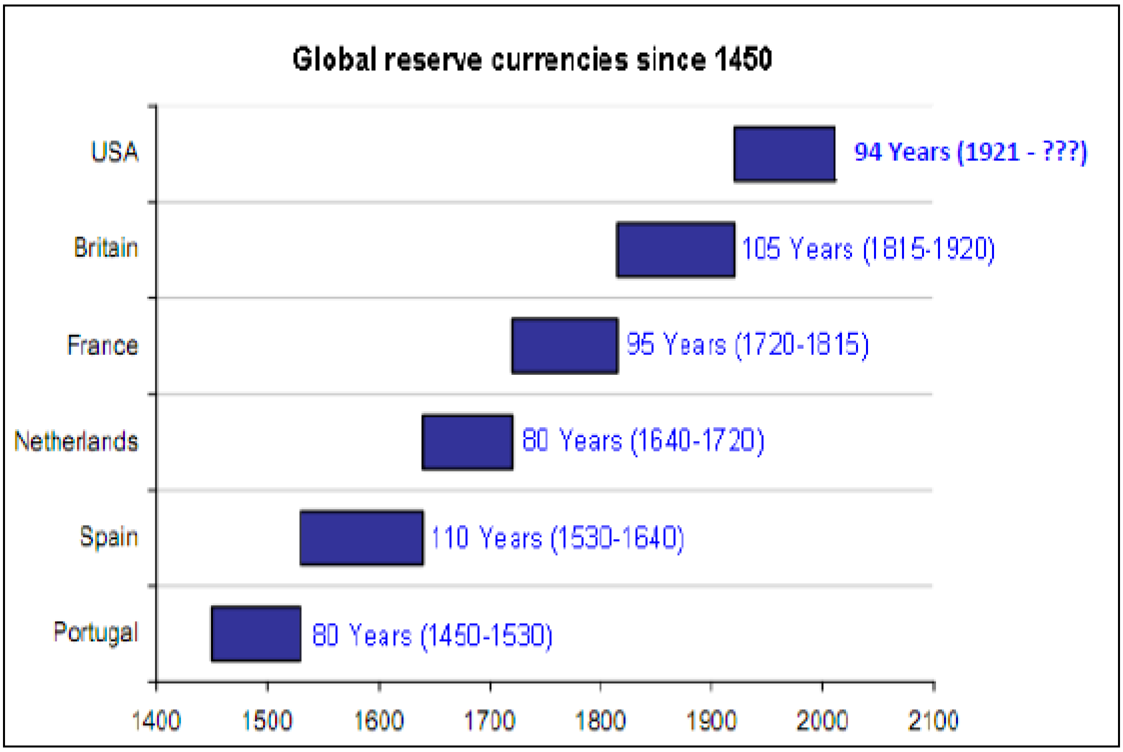
Poland should be a team player setting high thresholds for their allies because the risk it takes is an existential one. With nuclear weapon aimed at strategic targets in Poland from bordering Kaliningrad, Warsaw should develop its own military and economic potential under a pretext of strengthening the NATO. Simultaneous talks with the opposite camp could guarantee a position of a swing vote and a guaranteed spot at the winner's side no matter who wins.

Thanks to that Polish people could have a chance to continue being a sovereign during a scenario when China, Russia, and Germany defeats the US. A victory of the Eurasian block is becoming more probable taking under consideration foreign policy problems that the US is facing now. Reasonable leaders just like investors never put all eggs into one basket. This attitude is lacking in the Polish government.

Summary

The Sino-Russian alliance is a fact. Both sides wish to escalate the level of cooperation due to compatibility of their economies and a common enemy, which neither of them can beat on their own. The production capacities of Chinese corporation is the key here enabling projects like the "One Belt, One Road". Even without war those projects can marginalise importance of the US in the spectrum of international trade.

The pillar of the strategy to fight with the US is the financial battlefield and dethroning of the dollar. It is thanks to the status of the currency reserve that gives the US the advantage. Washington without the dollar would be like Russia without oil and gas.



Source: pragcap.com

Just like history tells us, the status of the reserve currency is not given forever. As with any power – the abuse of it – is what follows. When authorities abuse their privileged position it leads to crisis and ends up with the status being taken over by someone else. It will be no different for the US. After 2008, when markets lost their connection with the real economy, the petrodollar became unstable with oil price crash, the US treasuries sale and Washington-Riyadh conflict.

Against what the US mainstream media may tell you, the cooperation of Russia and China is accelerating. This puts into question strength of the NATO and whether the conflict for the world dominance will eventually be played out just like during the Second World War in Europe or will the South China Sea be its battlefield.

Independent Trader Team

The IMF and the Post-dollar World.

Last month James Rickards increased his presence in the media. It coincides with him promoting his new book. I try to follow his thoughts and reports as he is connected with people in the central bank, the World Bank, and Pentagon circles.

What grabbed my attention is his thoughts about the shape of the future IMF governed the monetary system. Rickard's is definitely not a prophet but where he draws the line may be similar to what we are going to see in the near future. What you will read is a combination of his suggestions, opinions of myself and people who I occasionally consult investment decisions with.

Insolvent central banks

For the last 40 years, we have seen constant growth of indebtedness on every level: individual, corporate and public. The expansion of financial sector being a result of legal manipulations and deregulation and inception of a market for derivatives led to the first serious crisis in 1998 when a hedge fund managed by two Nobel Prize winners went bankrupt. Long Term Capital Management thanks to a bad decision and huge leverage generated loss of few billion USD. To prevent the domino effect of bankruptcies the debt was bought by investment banks from Wall Street. Back in the days, it was an unprecedented bail-out.

The level of debt and leverage rose continuously until next crisis in 2008 when Wall Street banks were in trouble. Instead of letting them go bankrupt effectively cleansing the system, the FED printed out of thin air 800 billion USD and bought all toxic assets from those banks. It didn't end there. Between 2009 and 2010 Bernanke without consent from Congress and any other supervisory body printed another 16 trillion USD (more than the USD GDP then) and gave it as a credit to banks in the US, Japan and Europe. Only in 2011 we could hear about it but the case was quickly silenced. This already shows that central banks are beyond anyone's control.

Later central banks accumulated various assets to help their shareholders (commercial banks) and to prevent the total collapse of the monetary system from which they benefit the most. Today balance sheets of central banks are very rich:

a) Government debt – today bonds are the guarantee of a loss. For the last 30 years, central banks had a good run as yields were falling and the price was going up. With today policy of ZIRP (and sometimes NIRP) it will take a very small change in price for the bank to face insolvency.

b) Commercial debt – central banks stepped in because there was no buyer for corporate bonds. This can postpone cascade of bankruptcies and debt restructuring that could result in the fall of a few big investment banks. In other words – another worthless asset.

c) The debt secured by a real estate mortgage. Added to the list to again prevent the collapse of the system. Worthless.

d) Equities and real estate investment funds. After central banks were forced by swaps to increase the supply of a local currency, they acquired a surplus of USD. They invested this capital in equities and REITs. Contrary to the previous groups of assets this one has a significant value. The problem here is that volatility of price is dependent on the mood in financial markets.

e) Gold – the majority of investors don't know how much gold each central bank has. We can only look at official statistics but those are far from reality. Chinese constantly publish lower numbers than actual data. Germany on the other hand, has decent reserves. Berlin's gold is deposited in London and New York. In the case of any systemic problems it is hard to imagine anyone would be given their reserves. This would increase sovereignty at the expense of the hegemony across the Atlantic.

With today's prices, government bonds are the clear majority. With very high leverage of central banks, an increase of yield by 2-3% puts the bank on the verge of collapse, at least theoretically. We are talking about theories as there is no central bank audit on the horizon. There are no controls over them. A bankruptcy of a central bank would be initiated when a new design is ready for implementation. Those who will benefit from that change are probably working on a new monetary system as we speak: order out of chaos.

Another IMF bail-out

The only chance for buying a little time, Rickards thinks, lies with the IMF. The IMF is the issuer of the SDR – supranational currency with no backing in material goods. The SDR basket is no different than any other fiat currency. The issuer can without any control print the amount needed.

For the moment, the value of SDR amounts to 200 billion USD which is a rounding error on a global scale. The situation may change in the face of another global crisis. Just like Rickards said, if the SDR basket works is only because no one understands that it is just the same form of fiat money.

Another monetary crisis will most probably touch also central banks with their toxic assets bought systematically from insolvent governments (bonds) or commercial banks (junk assets). Under those circumstances, the IMF being supranational institution can offer a solution for such turbulent times. Ultimately no crisis should be left unused.

To decrease the central banks' debt the IMF can just take over the worthless assets in exchange for freshly printed SDRs. Slowly the IMF currency would gain function of a reserve currency after the USD. The dollar's role simultaneously should be reduced in a controlled manner in international trade and as a currency reserve of governments and central banks. The USD finally reduced to the national currency level would share the same fate as British pound.

The supply of the SDR then grows with each IMF's move. Later, few countries could gain the ability to issue debt denominated in the new currency and international corporations implement a new way to settle their deals according to the SDR basket.

Why would anyone accept the SDR?

Let's divide reasoning into two groups: threats and incentives.

Threats:

a) Destruction of a local currency.

A change of a monetary system is not an easy task. In the beginning, we need a crisis. An inflationary crisis coupled with an economic depression. The result: people need to require the government to do 'something'. From one side we have a destruction of a local currency, hyperinflation and an economic depression with all their consequences magnified by mainstream media. On the other hand, we have the proposition to join a new 'better' system.

b) Takeover of national wealth

The overwhelming majority of debt is denominated in foreign currencies. The respective country doesn't have the ability to print this currency in order to pay its obligations. When the danger of bankruptcy is looming (no creditors willing to rollover the debt), creditors supported with international organisations can ask for repayment or surrendering of national assets (highways, electricity networks, railroads). The alternative is a resignation of what is left of sovereignty and pegging the local currency with the SDR 'just like other countries'.

Incentives:

a) Partial reduction of debt

Every single time we transferred into a new system, part or all of the debt was being reduced. This time, should be no different. At the end of the day, the majority of national debt is owed to commercial and central banks and they can exchange it for a sum of SDRs from the IMF. The IMF can write off that debt using other solutions like revaluation of owned gold reserves.

In the case of monetary problems and potential instability and debt reduction – the choice is obvious. Politicians can boast that they achieved the best deal which reduces public debt to 40-50% of country's GDP. Long-term consequences of a total loss of control over the currency won't be found in the mainstream media, I can assure you.

Similar debt reduction (but only for the chosen ones) will be offered at the corporate level. It has been a visible trend for months now that global corporations are buying their own stocks financing it with a big amount of dollar debt. Nowhere in history can we find the scale of buybacks comparable to the last stage of the bull market. Their debt is now substantial and we can assume that their obligations could also be reduced to increase stability for the future.

b) End of currency volatility

For the last 40 years, we had a flexible exchange-rate system. This enabled a manipulation of exchange rates by commercial banks and introduced a lot of uncertainty with increased risk. Pegging currency with the SDR would fix the exchange rate which – under the control of the IMF – can be re-evaluated once per year of two.

Key role of China

During last decade, China accumulated the biggest currency reserves in the world. You shouldn't be surprised why they are the biggest proponent of replacing decaying USD by another form of the world reserve currency. When you have few billion dollars you can spend it on corporations, real estate or commodities. The problem starts when you own few trillions.

The introduction of the SDR could enable China to diversify their reserves. Let's say that during first 'print' China would receive 5% of the world's pool of SDR. If the equivalent of 1 trillion USD is printed, 11% of what the biggest central banks printed in 2008, it would be enough to deliver liquidity and ensure China diversify towards SDR.

China already keeps some SDRs in their reserves. From the new issue, they would receive an equivalent of 50 billion USD. In the liquid market, it won't be a problem to exchange a share of dollar reserves for SDRs. On top of that, new surpluses should be deposited in SDRs rather than USD. Liquidity should be on the rise as corporations and 'sovereign' states will have to issue their debt (at least a share of it) in SDR instead of local currencies. I'm sure international treaties and deals will see to that. The PBOC is already inviting the biggest Chinese corporations to issue SDR-denominated debt.

The fact that China is the biggest spokesman for SDRs is confirmed by opening second SDR trading platform in this country. The first one is managed by the IMF.

SDR and trust

This new currency is far from being different when it comes to fiat money. Just like Rickards pointed out very few understand how the system works. The SDR is nothing else but a variable of exchange rates of USD, EUR, JPY, GBP and since September RMB (Yuan). Maybe with time more currencies are going to be added like CHF, CAD, AUD or Indian Rupee. Still this is fiat money with no backing in a physical collateral.

Central banks and the IMF for years tried to install disgust for gold in people's minds and stop the historic role of money, gold has. Today most investors treat gold as a commodity equal to crude oil. The Perception is slowly changing. If people behind the system are able to live without gold then the old system of 'paper' dollars will be changed into new electronic SDRs. Thanks to that they will buy themselves another decade.

Unless people resist and put bigger trust in gold the new system will not use it. The SDR with partial backing in gold is not the same SDR destined to share the fate of any fiat money.

For gold to be a part of the new system its price has to be higher – 7-10 thousand USD per ounce. This can initiate inflation and devalue lion's share of paper debts. A higher price of gold can help financial institutions to repair their balances after losses of a written-off debt. What is more, in this new non-inflationary system, with low debt levels and high price of gold, investors would lose interest in precious metals. This can give the creators of the system control over currency creation and gold which it is based on.

We can speculate about time and shape of this new system. I showed you the shape and sketched its boundaries. The hardest part is always pinpointing the time frame. Changes that serious are not going to be implemented quickly. Also, the operation of such scale needs society's approval and for this, we need to have a crisis. The aforementioned calamity can sometimes get out of hand and make few banks fall. This might result in people's savings being lost and overall opposition against eliminating cash – one of the biggest goals of entities behind the shape of the new monetary system. As you can see there is a multitude of variables and this is why I believe that the SDR as an international currency will be taken seriously not earlier than in 3 years and not later than in 10 years' time. Unfortunately, the time frame is quite wide.

The crucial part of the SDR's role in the new system is the fact that any country accepting their currency being pegged to SDR, inevitably loses its monetary sovereignty. The end result in the micro scale can be observed in Greece. After losing monetary independence to the ECB the country itself is in freefall.

Trader21

The Other Face of a Crisis.

I understand that many articles on this portal may not have an overly optimistic tone. We are going to see another crisis which will make every meltdown before pale. The feature of every economic depression is a jump in the unemployment rate. The society stops spending, companies receive fewer orders and workers are fired, unemployment is on the rise, as a result, the society stops spending and so on.

A crisis has also the good side. It is a form of a market cleansing from companies delivering sub-standard services and products. Many of us remember the period of 2005-2007 when consumers relied on dishonest developers. There was no choice, every single one of them had more orders than he/she could handle and this led to pathology – the quality fell and prices increased. The crisis changed everything. Market consisted of specialised companies upholding high standards no matter how much workload they were receiving. It is because of that, they built their brand and today a crisis means to them less profit but not filing for bankruptcy.

During times of crises, the demand for goods and services is shrinking. But all crises finally end. The economy returns to the path of growth. Decimated companies cannot catch up with a number of orders and they grow. Unfortunately, a productive capacity cannot be easily multiplied.

This is exactly the moment many of young entrepreneurial minds are waiting for. An investment in oneself - education - or your company will give you much bigger return on investment than tech-equities gave in the '90s. Having your own company means more than just knowing your market and its interactions. It is the knowledge which cannot be bought with money. On the other hand, it means fighting for a client from the dusk until dawn. Spending all weekends on thinking 'what can I do better?' How to bring more clients or introduce another product? Nothing gives you more satisfaction than seeing your company growing and your hard work paying off.

Storm clouds are gathering and many of us have to stop for a second and think – what do you want from life? Do you like your job? Maybe you would feel better as an owner, not as an employee? Designing a product, preparing your research is not done in a month. Same goes for accumulating sufficient capital. The majority of people are not saving any money – this short term thinking can be described as - I got a raise, I can afford more, therefore, I spend.

Every business requires capital. If you have a good plan and believe in your success you can borrow money from your friends and family. However, many circumstances in this scenario may drain self-confidence from you and the feeling of insecurity can be fatal to the whole endeavour. Savings allowing us to live on a comfortable level can be the safety net during the first year or two since the inception of our company.

We should use our conviction and realistic planning to bring ideas before investors and other entrepreneurs. Many of them see the volatility of equity markets and a guaranteed loss, NIRP when buying bonds. Their money set aside for a better occasion can be used to support our start-up. This solution has one disadvantage – taking someone's money is less motivating than risking your own savings.

Where should I start?

First and foremost, what are you good at? What services or goods could you sell? Look for business having an unfair advantage, making it harder to copy. Talk to owners of other companies about your idea and ask them to criticize it. If they succeed and you lost all arguments – you should go back to design and improve the original version. It is better to lose an argument than money. Own your weaknesses and develop thanks to them. You still have time to prepare. The incoming crisis will create an economic vacuum which has to be filled by someone.

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The law of the unintended consequences and the government.

The inevitable is happening. The omnipresent socialism is reaping its fruits. Both developed countries and developing ones are battling with huge debt levels, budget deficits, and an overgrown public sector. The mechanism always looks the same: the government begins the term with low taxes, a small administration and then starts to give away money under the pretence of helping the poor. It doesn't take long for the number of the poor to increase as authorities cannot make ends meet with ever bigger deficits. To cover them they borrow big sums. Of course, they have to pay for additional liabilities: more bureaucrats are employed to manage an ever bigger system of controls and amount of certificates, while in the fog of blurred legislation the multinational corporations have enough space to flourish and avoid taxes. Before anyone could stop this avalanche, it is too late to intervene. The society lured into a 'free give away' policy will vote for those who can outbid the opponent.

It happens everywhere in the world and no region can feel secure from this wrecking ball of central planning. You may know it under a different name: 'social-democracy', 'neoliberalism', 'welfare capitalism', 'European Union'. As you can see the vocabulary evolved just like reasons to justify huge expenses by politicians.

Puerto Rico

Puerto Rico is an island South of Florida. It is a part of the US but it doesn't function like the rest of the Union. The Island is under the US jurisdiction, its currency is American dollar and citizens of Puerto Rico are also citizens of the US. The difference is that they do not pay federal taxes and have a big autonomy when it comes to legislation. Some parallels can be drawn between a member state of the EU and Puerto Rico being a part of the US.

Financial troubles pushing many Puerto Ricans to leave their home and crush the economy are directly caused by the incompetence of their government. Welfare programs and the burdensome public sector make taxes – from private enterprises and the tourism sector – not sufficient to fund expenses from the public purse. It is no surprise that budget deficit grows each year.

Only last year public debt reached 70 billion USD and ultimately stopped the economy from growing. In those conditions, business-owners cannot sustain their ventures and lose out to foreign competition both in the production and the tourism department.

Another factor working against the small economy is the USD. When the economy experiences problems its currency devalues. The devalued currency can impoverish the nation but it brings a competitive edge over foreign competition. This enables this country to export more successfully not to mention the cheaper cost for any visiting tourists. The influx of capital could buy time for the necessary reforms and settlements with creditors. Unfortunately, the strong dollar is preventing any of this from happening and keeps the Latin economy in the miserable state.

Results: growing emigration and the unemployment rate of 60% causing tax base to shrink. Even a tax haven status with which government tried to lure foreign capital, didn't help.

Although Puerto Rico is dependent on the US, the Congress refused to bail out the bankrupted economy. This makes Puerto Rico another Detroit. The government to pay social workers and police had to sell national jewels. Politicians are bad students and they haven't learnt anything. The debt is still on the rise and the only way out of this situation is severing ties with the US, creation of an independent currency and drastic cuts in government spending. This idea is promoted by Governor Alejandro Garcia Padilla.

Venezuela

Venezuela is the poster child of the political and economic consequences of handing over a country to socialists hands. Natural resources of Venezuela and its geographical location giving access to the ocean, warm climate – none of those advantages could stand a chance against the 'equality and social justice'. Venezuela after Chavez wasn't in the best shape but Maduro pushed the country off the cliff.

After nationalisation of oil reserves and burdening foreign capital with huge taxes, all international companies left Venezuela. Caracas introducing capital controls and high taxes made sure there can be no growth in the private sector. If this is not enough, the local mafia, armed better than the military is helping the corrupt regime.

To handle public spending and without any outside sources of financing, authorities turned to printing currency. As a consequence, the inflation rate during last 18 months reached over 1000%. Unemployment, lack of goods on the shelves and lynches of a chaotic mob is a regular picture in Caracas.

It is not a crisis – it is a result. The previous president of Venezuela, Chavez, repatriated gold reserves from the Fort Knox. This put Venezuela in the crosshairs of the US and Wall Street especially after the nationalisation of oil fields.

Another factor to contribute to the terrible situation was governmental policy to appease the crowd. High welfare payments and low gasoline prices drained too much money from the budget. The government grew more powerful and corruption was soon to follow – the privileged elite was stealing from their own people. The last nail in the coffin was quantitative easing – or printing the money – which decimated the economy.

The sheer scale of incompetence is best shown in the attempt to print Bolivar. Venezuela doesn't have enough printing presses to match the demand for fresh currency. The government outsourced printing Bolivar abroad. This causes another problem because they are asked to pay in the USD for the delivery. The US dollar is one of many things scarce in Venezuela. At the end of the day, even hyperinflation may not succeed in this model welfare state of Venezuela.

Vietnam

Vietnam is different from Venezuela. It doesn't have a problem with hyperinflation but rather with deflation. Vietnamese central bank tried to keep the dong-dollar parity but it resulted in the loss of money. The main reason for this is an amount of debt denominated in the American currency that had been taken by businesses . They had a choice of taking credit with 8% interest rate in VND or 3% in USD.

Vietnam faces strong competition from their neighbours – China, South Korea, Japan and Indonesia. They wanted to use every opportunity to develop their industry. Cheap credit used for financing operating costs was one of the methods they used. This debt additionally received governmental guarantees to ensure that costs of debt were even lower.

Vietnam started to experience problems when the dollar became stronger in the mid-2014. It gained on average 20-30% vis-à-vis emerging markets' currencies. For highly leveraged Vietnamese businesses it meant widespread insolvency. The cost of debt did not surge by a big margin but the exchange rate was very unfavourable. Since the beginning of 2015 central bank held onto the dollar peg but in August it allowed for rapid VND devaluation. As of today central bank is trying to keep the exchange rate of USD/VND stable but ultimately it is on the losing side.

Vietnamese business owners had to make a choice. Their situation was worsened due to decreasing volume of Vietnamese goods being traded – thanks to the financial crisis and low global demand. Growing liabilities denominated in USD and weakening VND put many companies out of business due to low liquidity. The necessity to pay growing amount of debt drained the economy from local currency and ultimately caused a currency deficit. Vietnamese are also losing their purchasing parity and the central bank trying to push the influence of the USD out of the country is not helping.

Summary

All those emerging economies experiencing a variety of problems have one common denominator. Central planning attempted by their regimes failed miserably. It didn't matter how noble the reason for intervention was. The law of unintended consequences does not discriminate when it comes to who conceives the plan. Unfortunately, plans made by the government tend to affect thousands if not millions of lives. From the perspective of probability, it is clear that when governmental plans are failing (and they do very often) they fail big.

While you were reading this piece you may have noticed some parallels to the policy of your own country. These problems are not exclusive to emerging world. They are indeed advocated by our own governments in our highly developed, rich economies. The only difference will be the height from which the economy (and we as a society) will fall unless politicians change their course.

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