



THE BANKRUPT SAVING THE BANKRUPT

“Paper money eventually returns to its intrinsic value – ZERO”

Voltaire 1729

Who will save the UK?

Last month we said that the UK would follow Iceland in a hyperinflationary depression. Just one month later our predictions are being confirmed both by events in the UK economy and in forecasts by the IMF as well as by several economists and money managers.

If we look at the chain of UK debtors, every link is on the verge of bankruptcy.

- The UK consumer debt is higher than GDP and unsecured personal debt is twice the level of the rest of Europe. The UK consumer debt has been built up during good times and there is no possibility that this can be repaid or even serviced during the prolonged depression that the UK is likely to experience in the coming years. **Thus the average consumer is very near bankruptcy.**
- A very conservative estimate of UK bank losses is £ 1.2 trillion which is twice the current UK public debt and 80% of GDP. Even if the losses reach £ 1.2 trillion only, UK banks can obviously not sustain these losses without continued government funding. **Thus the banks are virtually bankrupt.**
- Britain has foreign reserves of £ 43 billion only. UK banks have foreign liabilities of £ 3,000 billion. This mismatch is terrifying and a major reason why the pound has crashed and the IMF issued warnings on the UK economy. The UK Government does not have the reserves to support the massive losses of the banking system. They can only achieve this by printing money. **Thus the UK Government is bankrupt.**

- The IMF will then need to come to the rescue of the UK. Where does the IMF get its funds from? From the member states like the USA and the UK. But the UK is bankrupt and the USA is bankrupt and will have to print more money. **Thus the IMF is bankrupt.**

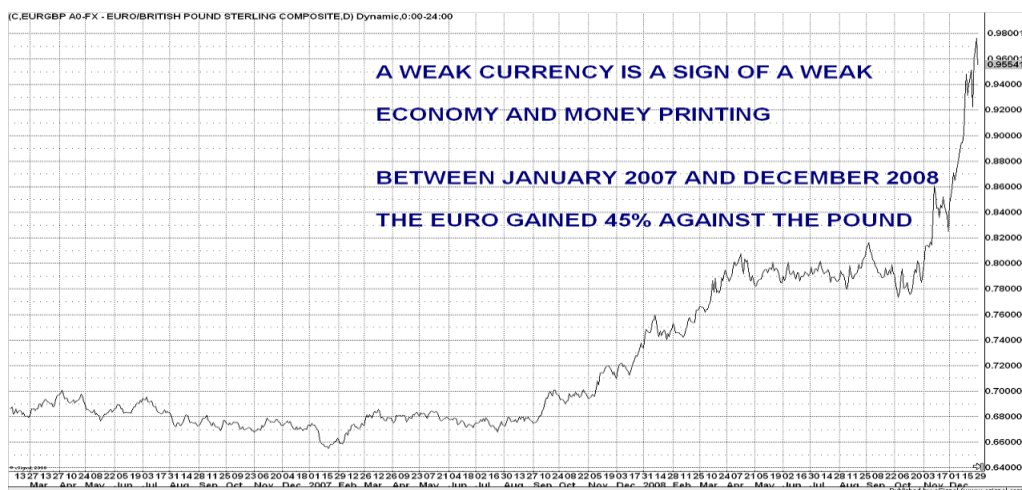
This is the bankrupt saving the bankrupt. There is no **real** money in the world that can save a bankrupt financial system – only printed paper money. This is why most currencies will become worthless leading to hyperinflation in many countries.

We took the UK as the example since events leading to these inevitable consequences have already started there. But the same thing will happen in the USA and many other countries.

The two charts below show what happens to a currency in a weak economy on the verge of bankruptcy. The first chart shows Gold in Pounds:



This chart shows the Pound against the Euro:



The FTSE 100 index has lost 85% against Gold in the last 9 years (not shown). Our projection is for an additional 90% fall.

You cannot solve a problem by making it bigger

The current world wide asset bubble and financial crisis has arisen as a result of a long period of unsound government deficit spending and of flawed interventionist monetary policies leading to artificially low interest rates. This resulted in a total flooding of the world with cheap money, based on unsound lending policies. The financial system also manufactured derivatives totalling circa \$ 1 quadrillion, of which a big percentage is worthless.

Thus the world has created a credit bubble which is unprecedented in world history both from the point of view of magnitude and the fact that it is affecting so many nations. And now governments are dramatically exacerbating the problem by expanding the bubble exponentially.

There is only one way to solve a problem caused by an exploding credit bubble and this is to let the bubble implode. This is of course totally unacceptable from a political point of view. No government or no opposition party would ever dare to propose this radical solution. But this would have the same effect a forest fire. Initially it would be devastating but it quickly leads to new strong growth creating a much healthier forest. The same would happen to the world economy. After an initial period of economic decline and hardship, there would be a solid foundation from which strong and healthy economic growth can take place.

What governments are doing instead is to prescribe the same medicine that caused the problem by printing unlimited amounts of money in order to support any bank, company, pension fund, insurance company, individual etc that is in trouble. Eventually, almost everybody will need to be rescued by governments. This will create massive additional debts that future generations will have to pay off for a long, long time. But since current debts can't even be repaid, new debts won't be either and instead, it will lead to a hyperinflationary depression. (Hyperinflation is normally followed by a deflationary depression but this will be discussed in a future newsletter). This whole process will be a lot more painful and prolonged than letting the system implode from current levels.

Bad bank – bad idea

The creation of a bad bank, funded by government money, to take over all the bad debts of the banking system will not work. The Swedish model in the early 1990's worked because it was in an isolated market. The collateral consisted mainly of properties which appreciated in value due to the market recovering, thus solving the problem. This time it is a worldwide problem and the property markets are unlikely to appreciate in real terms. Also, the biggest problem this time is the worthless derivatives which have no asset backing at all. Eventually the bad bank will be the only bank since there will be little business left in the good bank.

Social unrest spreading

Protests and strikes due to rising unemployment and hardening economic conditions are now spreading throughout many countries in Europe and in other parts of the world.

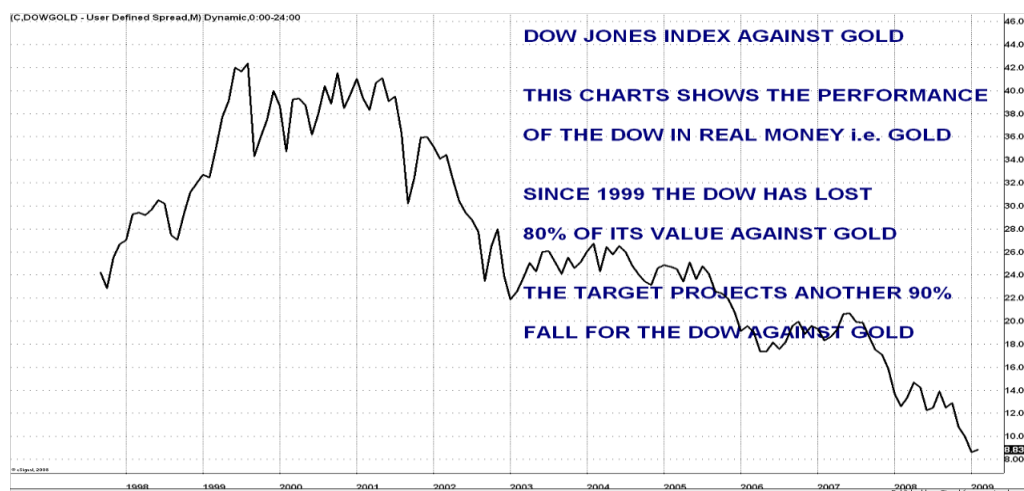
France, Spain, UK, Greece, Latvia, Lithuania, Hungary, Bulgaria have seen anything from protests and strikes to riots and bloodshed. China, Russia, Mexico and several countries in South America are experiencing similar actions.

It is estimated by the International Labour Organisation that 50 million people will become unemployed this year. In addition 200 million workers, mainly in developing countries, will be pushed into extreme poverty this year according to the ILO. The increased unemployment will lead to severe social unrest, increased crime as well as riots and fighting. In Europe there are more immigrants than ever. This was not the case in the 1930's. Economic hardship leads to blame, not only of governments, but also of minorities. Therefore the risk of clashes between ethnic groups in Europe is very high. The consequences could be very unpleasant. In the UK, protests and strikes against foreign EU workers taking British workers jobs are currently taking place. In France the protestors are in particular blaming bankers for the current problems and this is another group that is vulnerable to the people's wrath. But this is just the beginning. It will sadly get a lot worse and protecting property and family will be very important.

Markets

STOCKMARKETS are consolidating around the lows. We might see a new low before they turn up in a corrective rally. This rally could last from one month to a few months. In any case, the bear market will resume in earnest thereafter to much lower levels.

Against Gold which is real money, virtually all stockmarkets have lost considerable value. The chart below shows the Dow Jones against Gold. The Dow has lost 80% against Gold in the last nine years.



CURRENCIES. Governments will continue with their competitive devaluation game and all currencies will decline but they will take turns. We have seen the Pound decline by more than 30% against most currencies. The Euro and the Swiss Franc have lost more than 20% against the dollar since their 2008 peak. The Russian and Ukrainian currencies have lost 25% against the Dollar in the last three months. The next currency likely to decline will be the US Dollar. **In the end virtually every currency will return to its intrinsic value which is ZERO. No paper currency has ever survived in its original form.**

BONDMARKETS will cause the biggest surprise in 2009. There is a worldwide expectation that the deflationary contraction of the world economy will continue. But we are of the very firm opinion that the money printing will lead to worthless currencies and hyperinflation. Foreign investors of US treasury bonds will not only refuse to buy the \$ 2-3 trillion of new issues in 2009 but they will also start to liquidate their current holdings. This will lead to rapidly falling bond prices and much higher interest rates.

GOLD has during January 2009 made new highs against the Euro, Swiss Franc, Pound, Rouble, Swedish Kronor and many other currencies. Due to the temporary strength of the US dollar, Gold has not yet made a new high in dollars but it is only a matter of time before this occurs.

Summary

We took the UK this month as the example of the first major west European economy that is going through the classic stages of economic decline with credit and asset bubbles, money printing, currency collapse and social unrest. Gold anticipated these events already back in 1999. This was when Gordon Brown sold a major part of the UK gold holdings around the lows of £ 157 per ounce. Gold is now £ 630 per ounce, an increase of 300%. Only in the last two years gold has appreciated 50% against the pound. But we haven't seen the real effect of money printing yet in the UK or the rest of the world. That excitement is still to come. But it will only be exciting for investors who own physical gold and store it outside the banking system.

Matterhorn Asset Management based in Zurich, Switzerland specialises in wealth management and wealth preservation with particular emphasis on gold bullion and other precious metals stored safely in the investor's name outside the banking system. Contact us to discuss a wealth protection plan from € 100,000 and up as outlined on the Gold Bullion Investments Page.

Egon von Greyerz

Matterhorn Asset Management AG

Bahnhofstrasse 28A

CH 8001 ZURICH

Switzerland

Website www.mamag.org

Tel +41 44 213 62 45

Mob +41 78 845 30 14

Email [info\(at\)mamag.org](mailto:info(at)mamag.org)