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Market Comment

CLARMOND

From Golden Calf to Raging Bull.

Mankind's money has always existed on some kind of standard. Since governments untethered themselves from a fixed commodity standard during last century, current global central banks have provided us mortals the modern touchstone - the asset price standard.

Moses ascends Mount Sinai to communicate with the Almighty; his patience is rewarded with the Word of God on two stone tablets. As the great Prophet is absent for forty days and forty nights, the Israelites, nervous at his absence, plead to be given gods in which to trust. Aaron, Moses's brother, under pressure gathers up all the gold and casts the Golden Calf.

Moses returns with the ten commandments, sees the golden bull, is incandescent and orders Aaron to melt and grind the figurine into dust; he then commands the Israelites to consume it, after which thousands of the Israelites who worshipped the idol are put to the sword.

Something to trust in.

What can we learn from this Biblical tale? It is clear is that the Israelites, like us today, needed something in which to trust; they chose a golden bull, while Moses offered the actual Word of God that would become a benchmark that resonated through history and several belief systems. But markets demand a more tangible standard.

The Metal Standard

Historically, societies all over the world became tied to a regionally acceptable precious metal standard. In the East, the Chinese and Indians, worked within a silver based standard. In the West, gold rose to dominate, as the British Empire established its global hegemony and soon the planet was on a golden calf standard.

The first untethering to the gold standard was after the end of WWI, as Britain was burdened with war debt; the second unraveling took place in 1931 when Ramsey MacDonald could no longer balance the scales of unemployment and national debt; the final and definitive detachment from gold was in 1971, when Richard Nixon took the USA off the gold standard and the US$ floated into the future.

Secret love-child

What filled the golden gap? The growth of the credit sector, be it household, corporate, financial, or government. Credit creation exploded, along with the assets it purchased. This credit boom brought unprecedented prosperity, and dragged up asset prices, which are at the foundation of this ocean of obligations. The gold standard, long the mistress of many a central banker past, had now been replaced with a secret love-child - the asset price standard.

Asset prices are on the opposite ledger of credit liabilities. Any decline in asset prices implies a commensurate drop in credit. The asset price standard means that credit and asset prices must be steadily rising or reflated, otherwise the economy begins to decelerate.

Holy Cow!

Hence the consistent and continuing exhortations about the 'wealth effect.'

"Your assets are going up in value...you are wealthier...please, please spend more."

This has, in turn, led to historic raging bull markets in assets that are habitually reflated.

Each time asset prices come under threat the central banks are acting. What they are defending is the credit that underpins our current belief system, and this cannot be allowed to fail. In the gold standard, employment was sacrificed on the altar of gold. In the asset price standard, real income growth is relinquished.

In each reflation central banks tarnish their legitimacy through unconventional actions. In so doing they are creating their own credibility trap. Today we all clinging to the asset price standard created by our modern day Aarons. However, as our need for real income growth increases it becomes more and more likely that we shall be eating the dust of our asset price standard. ■