Chris Andrew
and Mustafa Zaidi
ca@clarmond.co.uk
+44 20 7060 1400

July 2014
Market Comment

CLARMOND

The Temptation of Idols

As monotheism up-ended the polytheistic world so did the central banks revolutionise the world of finance when they got rid of the gold standard in the 1970s. However, 40 years later it is less than clear that the replacement is any better.

THE SECOND COMMANDMENT OF the Decalogue states “thou shalt not make any graven image, or bow down to them, or serve them.” This direct prohibition against idolatry is a central pillar of monotheism.

Polytheistic religions focus on different issues, such as the pure and the impure, order and disorder. The king is also the ‘ruler priest,’ the earthly representative of the divine, whose objective is stability. This ruler priest magically summons up gods through ceremony to stem disorder. The second commandment deems such practice idolatrous and unjust. The one true God cannot be called up at convenience and such divine conjuring creates worth without work, and turns a trick into value. The anti-idolatry ordinance stands as an advert for justice and a rejection of wizardly workings.

Modern day wizards

Today’s central bankers have broken the second commandment by summoning up money without effort. This may be the core reason that the actions of central bankers sit uneasily with most people as they are interpreted as unfair and unjust.

Only four decades ago the worship of gold and its gold-standard ended. The shiny metal was branded a ‘barbarous relic’ by central banks who, like a latter day Moses, offered the public their ‘word’ instead; we could now rely upon the discipline of central banks to have stable money.

The Word Arrives

Until 1971 the god of gold sat atop of the money pantheon. There was a strict hierarchy of money in which the assets of one group, such as a central bank’s currency, became the liability of another, the deposits of a traditional bank. The final asset for all was utterly pure…gold, and it belonged to the central bank. The god of gold had no liability and this glistering asset was used as the collateral for the financial system.

The liberation from the gold standard was similar to the revolution brought by monotheism. In this case the idea of the pure asset (gold) was replaced with one of an accessible and fair asset (credit); the latter being backed by the ‘word’ of the central banks. In modern central bank parlance, this ‘word’ was the commandment of price stability, and the US Treasury Bond assumed the position of gold as the asset upon which the financial structure rested. The ‘word’ of the central bank was paramount, and their resolve was the standard for all prices.

Verbal seduction

Stable money was defined as having 2% inflation, and this was meant to apply to all prices, not just the present, narrow definition of consumer prices. But this new religion concealed the idol of asset prices and its mirror image of credit. Both demanded nourishing growth in order for central banks to be able to keep their word on stable money.

High Priests of Finance

The hymn of ‘rising credit, rising assets, stable prices’ was the central bank mantra, however, this bogus bewitchment has been exposed by the recent magical expansion of all central bank balance sheets. Today price stability is simply whatever the central banks say it is, not what we are actually seeing and experiencing.

Central banks, after a burst of emergency action in 2008/09, gradually revealed their ‘word’ to be unsound; they stayed in emergency mode for the next 5 years and directed asset prices. So much for the reliable ‘word.’

Ruler priests return

Central banks have mutated into the old gold standard that they dethroned; their actions are in utter thrall to asset prices, which they dare not upset. They have become the ruler priests of the asset-idol, touting its indispensability while molding its price. Such idol prostrations leave central banks vulnerable to market doubt and an open question - is the asset idol and the central banks that worship it, about to become the next ‘barbarous relic’? ■