CHALLENGES FOR THE GLOBAL FINANCIAL SYSTEM

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Abstract

According to the governor of the Bank of England, Mark Carney, the global financial system is currently lagging behind the evolution of the global economy, facing asymmetric concentrations of financial assets in advanced economies relative to economic activity. As the world re-orders, this disconnect between the real and financial is likely to reduce, and in the process other reserve currencies may emerge. By 2030, seven of the world's top 10 economies will be current emerging markets, according to the latest report by London-based multinational banking and financial service company Standard Chartered.

On the other hand, global tensions caused by economic sanctions and trade conflicts triggered by Washington have forced targeted countries to take a fresh look at alternative payment systems currently dominated by the US dollar. The global importance of the Chinese yuan seems destined to rise, according to strategists and economists who say flows in the currency will grow over the long term if Beijing continues to gradually open its financial system. The yuan will be increasingly driven by capital account flows, and not just trade-related flows.

Looking for a proper anchor of value for the international monetary system is becoming also an issue of a paramount importance. Gold is seen by an increasing number of players as a natural anchor of value and some are already preparing themselves to that by increasing their gold reserves. Holding physical gold is definitely the best hedge against a crash of any paper currency but nevertheless, we need a trustful worldwide monetary and financial system.

Keywords: *global financial system, reserve currencies, fiat currencies, gold, dollar, yuan.*

Introduction

The world re-orders and the worldwide monetary and financial system needs to be adjusted accordingly. Two issues have to be addressed in this respect:

1. The rebalancing of the global financial system in accordance with the evolution of the global economy and
2. The trust issue in respect to the USA dollar which is, for a long time, a fiat currency and is lately aggressively used as a sanctioning tool towards other states.

1. The rebalancing of the global financial system in accordance with the evolution of the global economy

According to the governor of the Bank of England, Mark Carney, the global financial system is currently lagging behind of the evolution of the global economy, facing asymmetric concentrations of financial assets in advanced economies relative to economic activity. As the world re-orders, this disconnect between the real and financial is likely to reduce, and in the process other reserve currencies may emerge.

Let us have a look at the present status and the forecasted evolution of the global economy.

Global merchandise trade reached a total of US$17.7 trillion in 2017**.** US$6.3 trillion were exchanged between developed economies (North-North trade), whereas trade among developing and transition economies (South-South trade) accounted for US$4.9 trillion. The remaining US$6.3 trillion were comprised of exports from developed to developing economies and in the opposite direction (North-South, and South-North trade). Thus, for developed economies, trade with developing economies was as important as trade with developed.

In 2017, developing economies shipped most of their exports to the United States of America (US$1.3 trillion), and then to China (US$1.0 trillion) and other Asian economies. They also sourced most of the imports from the same economies.

Despite efforts by the Trump administration to pressure Beijing into reducing the US-China trade deficit, the trade surplus with the US still reached $323.32 billion in 2018 – the highest level since 2006. The trade surplus grew 17 percent from around $275 billion in 2017. Exports to the US surged 11.3 percent year-on-year in 2018 to $478.4 billion, while imports from the US to China rose a scanty 0.7 percent over the same period.

The total value of **global e-commerce** transactions, both domestic and cross border, was also

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impressive, with US$ 16 trillion in 2013 (UNCTAD), US$ 25 trillion in 2015 (UNCTAD) and US$ 27.7 trillion in 2016 (The US International Trade Commission), with public traded companies like Alibaba, Alphabet, Amazon, Facebook, Microsoft, Netflix, Spotify leading the market.

Global services trade reached US$5.4 trillion in 2017, one third of the value of merchandise exports. Services exports mainly come from developed economies. These supply over two thirds of services traded internationally. However, several Asian developing economies have established themselves as important exporters. The world's top services exporter in 2017 was the United States of America, with US$781 billion worth of services sold internationally, representing 15 per cent of global exports. They were followed, at some distance, by three European Union member states (UK, Germany, France) that jointly captured 17 per cent of the world market.

The top five developing economies were Asian, comprising China, India, Singapore, Hong Kong SAR and the Republic of Korea. These five held a world market share of almost 15 per cent, the same as all other developing economies combined (UNCTAD Handbook of Statistics 2018, annex 6.4).

The rise of digital technologies promises to further transform international trade. We are entering a new era, in which a series of innovations that leverage the internet could have a major impact on trade costs and international trade. The Internet of Things, artificial intelligence, 3D printing and blockchain have the potential to profoundly transform the way we trade, who trades and what is traded.

The nature of competition in digital markets is materially different from competition in traditional markets as it tends to be based on innovation rather than on pricing. Questions have been raised about how much the adoption of digital technologies has raised economic productivity. Measures of productivity in the United States, for instance, suggest a significant slowdown since 2005.

Beyond facilitating trade in traditional services, digital technologies are enabling new services to replace trade in goods, ensuring the continued importance of services in the composition of trade. Another factor that could become more important for trade patterns in the digital age is market size. Digital technologies benefit from access to large amounts of information, which may be advantageous to large developing economies.

In 2017, **world foreign direct investment** (FDI) inflows decreased by 23 per cent to US$1.43 trillion. Thus, having reached a peak of US$1.92 trillion in 2015, investment fell back to 2013 levels. In developing economies, FDI inflows amounted to US$671 billion, almost double the value of FDI outflows (US$381 billion). Developing economies in Asia and Oceania accounted for more than two thirds of all developing economy inflows and more than 90 per cent of their outflows. Developed economies, by contrast, generate more FDI than they receive. In 2017, they recorded inflows of US$712 billion and outflows of US$1 trillion.

In 2017, developed economies' share of global outward FDI remained unchanged at 71 per cent. Over the last two years, developed economies in America accounted for an increasing proportion. Their share rose from 20 per cent in 2015 to 29 per cent in 2017, thus reaching the same share as Europe. On the recipient side, Asia and Oceania strengthened their position as the main host region of FDI in the developing world, accounting for one third of world FDI.

In the light of the above mentioned realities, we already perceive an asymmetric concentration of financial assets in advanced economies relative to economic activity. China is the leading exporter of the world, surpassing for the third consecutive year the USA. For the developing world it presents already the same importance as USA in terms of exports and imports. For developed economies, trade with developing economies is as important as trade with developed ones. As to the trade in services, five Asian countries held in 2017 the same market share in exports as USA did.

Regarding the FDI flows, developed economies still generate more FDI than they receive, but the share and value of FDI outflows from developing economies is on the rise. In addition we have to take into account some impressive holdings of USA debt by these countries, with China's bond holdings in excess of one trillion.

Even on the gold market, despite the fact that the largest transactions (considering the physical and non-physical ones) are still done on the London financial market, we see a shift of interest to the Asian market which is leading in terms of demand for physical gold and demands a more appropriate price formation based on transactions carried out there.

By 2030, seven of the world's top 10 economies will be current emerging markets, according to the latest report by London-based multinational banking and financial service company Standard Chartered. The long-term projection shows that India is likely to become larger than the US, while neighboring China will reportedly steal the crown of world's most powerful economy (currently held by the US) as soon as 2020. At the same time, Indonesia may break into the top five economies.

The question is how the structure of currencies in use for international payments and in the capacity of reserve currency reflects all these realities. As the world re-orders, this disconnect between the real and financial is likely to reduce, and in the process other currencies, with Chinese yuan to be first considered, will have to win their share.

The global importance of the Chinese yuan seems destined to rise, according to strategists and economists who say flows in the currency will grow over the long term if Beijing continues to gradually open its financial

system. The yuan will be increasingly driven by capital account flows, and not just trade-related flows.

Already, in respect of the World Currency Composition of Official Foreign Exchange Reserves, the international financial statistics of the IMF show that the shares of U.S. dollars in the allocated reserves of the states has decreased from 66.00% at the beginning of 2015 to 61.94% in the 3rd quarter of 2018. Shares of Chinese renminbi rose from 1.07% in 2016Q4 to 1.80% in 2018Q3.

2. The trust issue in respect to the USA dollar

The past year was full of events that inevitably split the global geopolitical space into two camps: those who still support using US currency as a universal financial tool, and those who are turning their back on the greenback. Global tensions caused by economic sanctions and trade conflicts triggered by Washington have forced targeted countries to take a fresh look at alternative payment systems and safe assets, currently dominated by the US dollar. Before looking into that, we have to address the wider issue of fiat currencies because dollar is in that position for a long time and some are asking for how long the agreement on this status quo is wise to prolong in the context of the dollar misuse.

2.1. Fiat currencies

Currency that a government has declared to be legal tender, despite the fact that it has no intrinsic value and is not backed by reserves is a succinct definition of fiat currency. Historically, most currencies were based on physical commodities such as gold or silver, but fiat money is based solely on faith.

What Marco Polo had come across in China in the 13th century was the paper money issued by the Yuan Dynasty under the rule of the legendary Kublai Khan. His people had been making use of paper money for several hundred years, dating back to the Song Dynasty in the 8th century. They had to take the value of the printed papers at faith, since they had no intrinsic value on their own.

In Europe the first real fiat currency didn't appear until 1661 in Sweden and then only to a limited effect. Some were tied to gold and silver; some were not. At times, both existed in some countries, with the paper money trading at a discount to the “hard money.” In colonial America, individual states issues “bills of credit” and various types of currency over the years. Once again, some were backed by silver or gold, but some were not.

By the turn of the 20th century, most nations had made themselves the sole issuer of bank notes and legal tender. The economic havoc and immense cost of World War I led to the end of conversion of currencies for specie across the board, leading to an infamous example of a pitfall of fiat currencies. Between wars, currencies were extremely volatile. Hyperinflation led to severe deflation and depression. World War II brought another period of intense government intervention in economic activity, price controls, and monetary policy. As the world reemerged from the cataclysmic wars, there was broad consensus amongst the major powers that something had to be done to stabilize currencies, exchange rates, and economies, and to rebuild faith in government control of all of the above.

What emerged was the Bretton Woods System (1944), in which all of the nations tied their currencies to the U.S. dollar through fixed exchange rates. The U.S. dollar was still convertible to gold, but only for central banks. On August 15, 1971, President Nixon unilaterally ended it. It was now a pure fiat currency. The dollar plunged by a third during the stagflation of the 1970s, and currencies destabilized worldwide. What emerged has been called Bretton Woods II, although it wasn't coordinated at all. An international system of interdependency between states with generally high savings in Asia and Western states with generally high spending emerged. This paradigm lasted until about five to ten years ago.

With the global recession and currency wars raging to this day, there are renewed calls for worldwide standards for currencies and banks. Banking regulations in the U.S. and in Europe have been used to address the credit crisis during the recession, resulting in unorthodox monetary easing policies from central banks, but there are still no binding international standards for currencies.

Inflation, hyperinflation, and deflation are all still on the table as individual currencies are completely independent. Fiat currencies only work when inflation is low or moderate. Responsible management by central banks can keep the possibility of high inflation and deflation in check through interest rates and monetary supply. With the Fed's unprecedented expansion of the monetary base, and with interest rates at virtually zero percent, it has no ability to further stimulate the economy without dumping more dollars into circulation. We haven't seen the inflation and depreciation of the U.S. dollar that would be expected so far. But many worry about a delayed effect of the Fed's actions. When a currency is weak, or a central bank is using risky policies that create a loss of faith and an ailing economy, it is better to shift your money into traditional stores of wealth like gold or silver. Without a commodity or good used as a peg for value, there is a point of no return in the collapse of a government, national economy, or both that marks a point of no return for its currency.

“A truth of financial reality is that any prosperity built on paper money has usually been fun for a while, but has always ended in catastrophe” (from Jim Dines’s 1975 book, The Invisible Crash). Jim Dines predicted that gold would enter into a historic bull market, rising from government-fixed levels of $35 to over $400. Not only that, but on January 14, 2005, Dines explicitly warned of the coming real estate crash of 2008, saying

it would teach a lesson in illiquidity and shake the mortgage markets to its roots.

And right now, Dines is issuing another urgent warning. Americans have been unrelentingly assured by the Washington economic establishment that the economy is still recovering from the 2008 Great Recession. But he has never accepted that there's been a recovery. All that’s happened since, including the “rebound” in stock prices, has simply been the result of printing breathtakingly large amounts of money and debt. Now, America is saddled with $22 trillion in debt and that figure doesn’t even take into account the “unfunded liabilities” like Medicare, Medicaid, Social Security and student loans. The debt is huge and there’s no possible way to pay it down. Before long, payments on the debt will become the third-largest item in the federal budget and something is going to break.

Jim Dines has long warned that cutting the dollar’s link to gold wouldn’t just lead to chaos, it would be the dollar’s death knell. Currencies not backed by anything tangible, like gold or silver, have always left debt and destruction in their wakes. There isn’t a paper currency on Earth worth trusting as much as gold and silver. As Dines likes to point out, all countries print money with almost no connection to real wealth. Many countries back their currencies not with gold, but the paper money of other nations. He compares the world’s currencies to a bunch of staggering drunks trying to hold each other up. When a key one falls, the whole group will go down. Currency crises will keep happening with increasing frequency until gold is restored as the primary monetary asset.

2.2. Sanctions

We can see that, based on the need of rebalancing the new configuration of economic power with the global financial system and triggered by global tensions caused by Washington, a trend has emerged across the world toward reducing the dollar’s role in trade and finance.

The US uses sanctions against other nations as part of its strategy to protect the current global financial system, in which the US dollar plays a dominating role but at the same time it have forced targeted countries to take a fresh look at alternative payment systems and safe assets. Some steps are pointing to that:

a) Challenging the status of a fiat currency
b) Challenging the reserve role of the dollar
c) Challenging the petro-dollar
d) Challenging the dollar as a means of payment or as a third currency in bilateral non-oil transactions

a) Challenging the status of a fiat currency

The global debt has soared to $247.2 trillion in March 2018 (as for the Washington-based Institute of International Finance statistics of August 2018). Central banks have been printing trillions of dollars out of thin air. By the beginning of 2020, global debt could be as high as $300 trillion. According to the IMF, in 2016, the countries with the largest debts, both public and corporate, were the United States with over $48.1 trillion, China with over $25.5 trillion and Japan with over $18.2 trillion. In 2016, the global debt was already at $164 trillion, which was equivalent to 225 percent of global GDP. The global debt-to GDP ratio currently exceeds 318 percent.

“The entire planet is swimming in debt, yet no one seems to criticize the system itself as being fundamentally flawed… our current financial system enslaving the entire world is not sustainable and headed for one hell of a spectacularly ugly crash” Darius Shahtahmasebi, a New Zealand-based legal and political analyst said.

Over-indebted countries are at risk of getting into serious financial trouble.

“The last geopolitical shift that started with WWI and ended with WWII put the US in this dominant position, because they owned and stored 70 percent of the gold reserves of the free world. This was also the main reason, why the USD became the world currency reserve. Central banks moved their gold because they felt threatened by the USSR and saw the USA as their natural ally. The fact that central banks are repatriating their gold shows that this has changed. It also implies that they don’t see Russia as a bigger threat than the USA any longer. Europe stands in the center of this geopolitical power shift and some countries obviously believe it’s wise to store the gold in their home countries” Claudio Grass, an independent precious metals advisor said.

“Nonetheless, it is obvious that the systematic problems are not solved, on the contrary, the risks became bigger and more fragile than a decade ago,” said Grass. “As you know more than 65 percent of all monetary reserves in the central banking system are held in the world currency reserve, which still is the USD. Therefore, holding physical gold is definitely the best hedge against a crash of any paper currency, and “therefore also against a crash of the USD”.

Also Kim Dotcom, an American analyst and businessman is telling us straightforward: dump 'worthless' dollar in favor of gold and crypto as US debt spirals out of control.

The amount of gold bought by global central banks in 2018 reached the second highest annual total on record, according to the World Gold Council (WGC). The industry research firm said that central banks bought the most gold by volume since 1967. It was the largest amount since former US President Richard Nixon’s decision to end the dollar's peg to bullion in 1971.

According to the WGC, central bank net purchases reached 651.5 metric tons in 2018, 74 percent higher than in the previous year when 375 tons were bought. It has estimated that they now hold nearly 34,000 tons of gold.

“Heightened geopolitical and economic uncertainty throughout the year increasingly drove central banks to diversify their reserves and re-focus their attention on the principal objective of investing in safe and liquid assets,” said the report.

It noted that Russia was leading the way as it looks to reduce reliance on dollar reserves. The Russian central bank bought 274.3 tons of gold in 2018. Other big central bank buyers were Turkey, Kazakhstan, India, Iraq, Poland and Hungary.

Russia became the world's fifth largest holder behind the US, Germany, France and Italy.

It also said that Russia has cut the share of the US dollar in the country's foreign reserves to a historic low, transferring nearly $100 billion into the euro, the Japanese yen and the Chinese yuan. The step came as a part of a broader state policy on eliminating reliance on the greenback.

China has joined the global gold rush, increasing its gold reserves to US$79.319 billion (by more than $3 billion compared to the end of 2017) trying ”to diversify its reserves” away from the greenback.

Russia, China and Turkey are leading the gold-buying spree. “They are forcing revision and re-introduction of the gold standard,” agrees Max Keiser, adding that all those three countries have to do is ”introduce gold-backed currency.”

The latest trend among European countries of bringing home their gold reserves has been raising concerns in Brussels. According to Claudio Grass of Precious Metal Advisory Switzerland, the process means disintegration, which usually comes with instability, unrest, more government intervention and control. Analysts have pointed out that EU countries see gold as insurance in case they end up returning to their national currencies.

b) Challenging the reserve role of the dollar

In 2016, the Chinese yuan was included in the Special Drawing Right (SDR) basket alongside the US dollar, the Japanese yen, the euro, and the British pound. The move granted the yuan the status of a reserve currency.

The Chinese yuan has strengthened its position among global reserve currencies, rising to 1.84 percent in the second quarter of 2018, according to the International Monetary Fund.

Central banks held $193.4 billion worth of yuan.

The 1.84-percent share is still modest compared to other global currencies like the US dollar, euro and Japanese yen. The share of US dollar reserves decreased to 62.25 percent in the second quarter of 2018 to its lowest level since 2013.

Global financial transfer system SWIFT said in its recent monthly report on the yuan that it was the sixth most used currency in domestic and international payments value in October, just behind the Canadian dollar.

“The yuan will be increasingly driven by capital account flows, and not just trade-related flows,” said HSBC. It pointed out that China's financial opening accelerated this year, with portfolio investments by foreigners reaching an all-time high. The bank expects a significant shift coming as China opens the door further: “We believe this is only the beginning of a multi-year trend for portfolio investment rebalancing, globally.”

Yuan-denominated Chinese bonds were included recently (on the 1st of April 2019) in the Bloomberg Barclays Global Aggregate index. The move is expected to attract trillions in foreign inflows into China and the reshaping of global capital markets. Over the next 20 months, the index will add 364 bonds issued by the Chinese government. Analysts estimate the full inclusion will attract around US$150 billion of foreign inflows into China's bond market, which is the third-largest in the world after the US and Japan. Meanwhile, several other key index providers (including the JPMorgan Government Bond Index-Emerging Markets and the FTSE World Government Bond Index) are also considering whether to add Chinese bonds in their benchmarks. It is estimated that China would receive as much as $275 billion in foreign inflows as a result of its bonds being added to indexes by Bloomberg, JPMorgan, and FTSE. That would help increase the Chinese yuan's share in foreign currency reserves held by central banks globally. For now, despite the Chinese bond market's large size, the bonds are under-owned by global investors. Foreign holding of Chinese debt stands at only two percent of the $13 trillion in total value. Chinese central government bonds have already a foreign ownership at close to 8 percent, but that is still very low compared to 35 percent for US Treasuries and 28 percent for British government debt.

The People's Bank of China has been also regularly reducing the country's share of US Treasuries. Still the number-one foreign holder of the US sovereign debt, China has cut its share to the lowest level since May 2017.

The Central Bank of Russia has moved further away from reliance on the US dollar and has axed its share in the country's foreign reserves to a historic low, transferring about $100 billion into euro, Japanese yen and Chinese yuan.

The share of the US currency in Russia's international reserves portfolio has dramatically decreased in just three months between March and June 2018, from 43.7 percent to a new low of 21.9 percent, according to the Central Bank's latest quarterly report, which is issued with a six-month lag. The money pulled from the dollar reserves was redistributed to increase the share of the euro to 32 percent and the share of Chinese yuan to 14.7 percent. Another 14.7 percent of the portfolio was invested in other currencies, including the British pound (6.3 percent), Japanese yen (4.5 percent), as well as Canadian (2.3 percent) and Australian (1 percent) dollars.

“It is more of a game changer for the US. As soon as other nations have a real credible alternative to the US dollar, they can dump dollars and switch to the yuan which can spark a dollar crisis. If that happens, not only will there be inflation from the tariffs, but also from the flood of dollars,” said Ann Lee, Adjunct Professor of Economics and Finance at New York University and

author of the book 'What the US Can Learn From China'.

c) Challenging the petro-dollar

The highly anticipated yuan-backed crude oil futures have been launched in Shanghai International Energy Exchange in 2018. China is the world's biggest oil and in 2017 it outpaced the US as the world's number one importer of oil. Thus, the contracts may not only help to win some control over pricing from the major international benchmarks, but also promote the use of Chinese currency in global trade and diminish the role of the greenback in global financial markets. The futures contract will allow participants to pay with gold or to convert yuan into gold without the necessity to keep money in Chinese assets or turn it into US dollars.

"In the short-term, we believe price fluctuations will reflect domestic crude oil supply and demand. In the long run, yuan crude price will mirror the moves of Brent," said Chen Tong, Shanghai-based senior crude analyst at First Futures. Meanwhile, the high costs of oil storage for delivery into the Shanghai Futures Exchange may scare potential investors away from the new contracts.

Stanislav Werner, head of the analytical department of Dominion, notes that the oil market is worth $14 trillion at the moment, and is bigger than the Chinese economy.

With crude oil becoming also a great chunk of international commerce (with 2 trillion worth of trade in 2017), the potential impact of the new product on oil market dynamics and on global monetary and financial systems could be correspondingly great. That is why "the US has a serious reason to get nervous, because in many ways the hegemony of the US dollar came from oil trading in dollars" Werner said.

As China is the world's biggest crude buyer, the new contract may allow exporters to avoid US sanctions by trading oil in yuan. Such countries as Russia, Iran, Pakistan, Vietnam, China and many other Asian countries are interested in that. Iran will accept renminbi from China now. China and Russia have currently swaps in rubles and renminbis. Caracas has ordered oil traders to convert crude oil contracts into euro and not to pay or be paid in US dollars anymore.

"When US dollar replaced the pound sterling, there was no one really going around trying to do it quickly. But now you have major economies like Russia, China, Iran and others that want this to happen. So, it will happen faster," Jim Rogers added.

"Ideas related to oil trade in currencies other than the dollar arose more than once. Some of them were severely suppressed by the United States, one example is Muammar Gaddafi, who proposed the introduction of a regional currency gold dinar and trading oil in the Middle East in this currency… China has a chance to finish what he started" Aleksandr Egorov, foreign exchange strategist at TeleTrade, told.

"Along with the Chinese role in the global economy and the growing interest in the renminbi, China is also protected by a nuclear shield. It can afford to try to shatter the monopoly in oil trade. This will give even more weight to the Chinese yuan. In addition, China's economy is the world's largest consumer of oil, and consequently, all world producers of raw materials will have to reckon with the strategy of the Chinese authorities," Egorov said.

d) Challenging the dollar as a means of payment or as a third currency in bilateral non-oil transactions

China is trying to internationalize its own currency. Beijing has recently made several steps towards strengthening the yuan, including accumulating gold reserves, launching yuan-priced crude futures, and using the currency in trade with international partners. The Hong Kong Exchanges and Clearing also launched yuan-denominated gold futures in 2017. A metals futures contract denominated in Chinese currency was expected to be launched at the London Metal Exchange in 2018, while the use of the Chinese currency as collateral was already in place.

As part of its ambitious Belt and Road Initiative, China is planning to introduce swap facilities in participating countries to promote the use of the yuan. Moreover, the country is actively pushing for a free-trade agreement called the Regional Comprehensive Economic Partnership (RCEP), which will include the countries of Southeast Asia. The trade pact could easily replace the Trans-Pacific Partnership (TPP), the multi-national trade deal which was torn up by Donald Trump shortly after he took office. RCEP includes 16 country signatories and the potential pact is expected to form a union of nearly 3.4 billion people based on a combined $49.5 trillion economy, which accounts for nearly 40 percent of the world's GDP.

A bilateral currency swap agreement worth $28.81 billion has been clinched between China and Indonesia (November 2018). China's central bank signed the similar deal with the Bank of Japan (October 2018). Moscow and Beijing are working on an inter-governmental agreement to boost the use of the ruble and yuan in mutual trade settlements (in 2017 nine percent of payments for supplies from Russia to China were made in rubles while Russian companies paid 15 percent of Chinese imports in yuan).

India is one of the biggest merchandise importers and is significantly impacted by sanctions applied to its trading partners. Delhi switched to ruble payments on supplies of Russian S-400 air-defense systems as a result of US economic penalties introduced against Moscow. The country also had to switch to the rupee in purchases of Iranian crude after Washington reinstituted sanctions against Tehran. In December, India and the United Arab Emirates sealed a currency-swap agreement to boost trade and investment without the involvement of a third currency.

Ankara is preparing to conduct trade through national currencies with China, Russia, Ukraine. **Turkey** also discussed a possible replacement of the US dollar with national currencies in trade transactions with Iran. In August 2018, Qatar and Turkey inked a

currency swap agreement to boost liquidity and provide financial stability due to hostile US rhetoric towards Ankara, and the economic blockade Doha faced from its Gulf neighbors led by Saudi Arabia. The Turkish economy sank after Washington introduced economic sanctions over the arrest of US evangelical pastor Andrew Brunson on terrorism charges. The lira has lost nearly half of its value against the greenback over the past year.

Sanctions have forced **Iran** to look for alternatives to the US dollar as payment for its oil exports. The latest round of penalties that went into effect on November targets Iran's energy, finance and shipping sectors. Washington also threatened to introduce secondary sanctions against countries and corporations that continue to do business with Tehran. Earlier, the White House sanctioned Iran's auto industry, carpets, metals trading and access to US dollars. Monetary transactions have become difficult for Iran after the country was cut off from the SWIFT payment system. Without access to SWIFT's interbank payment system, Iran cannot get paid for exports and pay for imports. Iran clinched a deal for oil settlements with India using the Indian rupee. It also negotiated a barter deal with neighboring Iraq. **Iraq** wants to barter food for desperately needed Iranian gas supplies.

Russia is among the countries pushing for "de-dollarization" (exclusion of the dollar in domestic and international financial interactions). Part of it is its record accumulation of gold reserves. Russia has developed a national payment system as an alternative to Visa and Mastercard and has managed to develop a national system for money transfers that could protect its banking from the possible cut off from SWIFT transfer services in case of tougher US penalties. Moscow has managed to partially phase out the greenback from its exports, signing currency-swap agreements with a number of countries including China, India and Iran. Russia has recently proposed using the euro instead of the US dollar in trade with the European Union.

Russia's largest energy companies preparing to substitute petrodollar in favor of the euro and other currencies in international settlements. Gazprom Neft, Russia's third-biggest oil company by output, said its contracts already have a clause to trade without the US dollar. The largest Russian oil company Rosneft is also interested in diversifying. The firm has opened banking accounts in Hong Kong dollars and Chinese yuan. Surgutneftegas is also reported to be working to reduce dependence on the dollar.

"The new US sanctions are clearly aimed at providing the US with economic advantages, including at the expense of European companies," said the chairman of the German-Russian Chamber of Commerce Matthias Schepp in December 2018. "It's time for Russia and Europe to start looking together for a way out of the sanctions regime," said Schepp.

Two-thirds of German companies doing business in Russia back the idea of setting up a dollar-free alternative payment system.

The **BRICS** countries consider switching to local currencies for mutual settlements with the Chinese yuan as the lead currency. The New Development Bank (NDB) is expected to be a substantial player in the process. The five banks of the BRICS Interbank Cooperation Mechanism have agreed to establish local currency credit lines. BRICS countries are also considering own cryptocurrency as settlement mechanism.

Russia suggests creating single virtual currency for BRICS and **Eurasian Economic Union** (EEU). Also more than 40 countries and international organizations, including China, Indonesia, and Israel, as well as some South American countries, have expressed interest in a free-trade deal with the EEU. The trade bloc is also holding negotiations with South Korea, Egypt, and India. It is expected that at least a part of trading will take place in other than dollar currencies.

Even **Europe** is working on a payment system alternative to SWIFT & IMF in order to attain financial independence from US.

Conclusions

Two trends are to be already seen these days:

- switching to other currencies and payment systems. In the case of China this is a part of its rebalancing strategy aimed at narrowing the gap between its economic power and the role of yuan in the worldwide monetary and financial system. For other countries this emerges from the need of hedging against the sanctioning policy of the USA.
- looking for a proper anchor of value, which could be once again gold, since the main reserve currencies are fiat currencies and the huge debts and growth issues are threatening their prospects.

So, while the mainstream financial press is all sunshine about the economic and financial prospects of the USA, there is a core group of financial gurus who do not agree with it.

Ron Paul, the Libertarian-minded congressman from Texas has never been shy about his distrust of the American monetary system or about his fondness for gold, as indicated by the titles of his best-selling books: "End the Fed" and "The Case for Gold".

While some have written Ron Paul off as paranoid, he has predicted almost every geopolitical event of the last 10 years, from the Arab Spring to the financial crisis, from exploding deficits to the expansion of the Fed, and from record gold prices to the current Iranian oil skirmish (all of them in a single speech from 2002).

At the same time, Paul is no typical congressman. While a typical Congressional portfolio has an average of 10% in cash, 10% in bonds or bond funds, 20% in real estate, and 60% in stocks or stock

funds, he has about 20% of his holdings in real estate, 14% in cash and 64% in gold- and silver-mining stocks.

Peter Schiff is also warning against dollar: "It's important to know what types of investments to avoid. Treasuries, or in fact any dollar denominated debt, needs to be avoided because again, either you are not going to be paid back or you are going to be paid back in money that doesn't buy much. So, either way you are losing. So you have to protect yourself; gold/silver, commodities in general, stocks are a way to go although I like foreign stocks better than most domestic stocks, and emerging markets."

Can we see euro as a solid alternative currency? It is hard to believe that unless some serious changes are made.

The decision to create a single currency without the institutions which would make it work was "fatal" for the Eurozone, said Nobel-Prize winning economist Joseph Stiglitz, adding that the "Eurozone must ditch it now to survive".

In his book 'The Euro: How a Common Currency Threatens the Future of Europe, the economist writes the Eurozone was flawed at birth and is destined to collapse unless huge changes are made to its common currency. The structure of the Eurozone, its rules and regulations, was not designed to promote growth, employment and stability. The economist suggested the best way forward for the euro area is a 'flexible euro,' where each member country adopts its own version of the currency. A flexible euro could help southern European countries export more and import less, helping to achieve a trade balance and full employment.

The Eurozone's single currency, the euro, has been a serious drag on the economic growth of almost every member of the bloc, according to a study by German think tank, the Centre for European Politics (CEP) published in February 2019.

Germany and the Netherlands, however, have benefited enormously from the euro over the 20 years since its launch, the study showed. The currency triggered credit and investment booms by extending the benefits of Germany's low interest-rate environment across the bloc's periphery. However, those debts became hard to sustain after the 2008 financial crisis, with Greece, Ireland, Spain, Portugal and Cyprus forced to seek financial aid as growth slowed and financing became scarce.

According to CEP, over the entire period since 1999, Germans were on average estimated to be cumulatively richer by €23,000 than they would otherwise have been, while the Dutch were €21,000 wealthier. To compare, Italians and French were each €74,000 and €56,000 poorer, respectively.

Study authors Alessandro Gasparotti and Matthias Kullas said most Eurozone members had enjoyed periods during which the currency union had been net positive, but these were far outweighed by the periods when it dragged on growth. The study concluded that since the loser countries could no longer restore their competitiveness by devaluing their currencies, they had to double down on structural reforms.

In Europe we also witnessed unorthodox monetary easing policies from the European Central Bank, fortunately not to their extent in USA. The prediction of Nouriel Roubini that the Eurozone will begin breaking up could be just not out of this world. However, with no binding international standards for currencies, euro is certainly a fiat currency too. According to Claudio Grass of Precious Metal Advisory Switzerland "Our system is based on 7 percent paper notes and 93 percent digital units backed up by nothing other than central bank promises to pay back the debt in the future through inflation and taxation. It is just a matter of time before the Euro, the most artificial currency ever, is going to collapse" .

China has also to overcome a crises situation potentially endangering its national currency. Jim Dines has repeatedly predicted that "Its bear market would begin in real estate and banking." Especially considering the scope of its "shadow banking," or banking outside traditional institutions, where there is less oversight. Experts estimate that these transactions have at times been worth an astounding 87% of China's GDP.

China is also quietly desperate to stop its growing housing bubble. House prices in large Chinese cities in 2018 were among the highest in the world in terms of price-to-income ratios, with speculative demand from Chinese investors who see few other good places to park their savings. The result is a staggering 50 million empty homes. China has levied a new housing tax to try and slow the spreading of the bubble. But even if the new tax manages to temper housing prices, it's certain to suck more cash from the already debt-laden population.

London is experiencing some trouble with its pound for some time now, due to the unsolved Brexit, while other trends are also detrimental to it in a longer perspective. The role of a gold depositor is put into question as some countries, whose gold is kept in London coffers, are making the arrangements of bringing it home (see Germany, Hungary, Romania). Others, like Venezuela, are on no legal terms, refused in this respect. The physical gold transactions in London are losing ground to those in Asia where the greatest consumption is located. The derivatives transactions will follow this move. An increasing share of gold futures in London will be denominated in the Chinese yuan instead of British pounds. The Brent benchmark will lose ground to the Shanghai crude oil benchmark. More and more financial institutions are leaving London. The pound will have to mirror those changes.

We can see that, based on the need of rebalancing the new configuration of economic power with the global financial system and triggered by global tensions caused by Washington, a trend has emerged across the world toward reducing the dollar's role in trade and finance.

According to the governor of the Bank of England, Mark Carney, the transition from the dollar to another currency that could become prevailing wouldn't be quick. The greenback has been dominating over the last hundred years after it replaced the British sterling as the key reserve currency. "History suggests these transitions will not happen overnight. The US economy overtook Britain's in the second half of the 19th century, but it took until the 1920s before it became a dominant currency in international trade," Carney said.

It will take some time for the Chinese yuan to gain its fair share in international trade and finance, but the process has started and will be far quicker than the replacement of the British sterling with the dollar.

Looking for a proper anchor of value for the international monetary system is becoming an issue of a paramount importance since the trust in the main currencies is sloping down by the day. Gold is seen by an increasing number of players as a natural anchor of value and some are already preparing themselves to that by increasing their gold reserves. Holding physical gold is definitely the best hedge against a crash of any paper currency. Nevertheless, we need a trustful worldwide monetary and financial system. Paper money should be backed by gold through a comprehensive agreement signed in Bretton Woods or Shanghai. As this scenario of common sense will be strongly opposed by the "dollar establishment", we could see first a "gravitational scenario" when one or more countries will come up with gold-backed currencies, making them trustful means of value storage for those in search of minimizing the risks.

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