Midsummer Nightmare

Professor Fekete, Gold & The Collapse of Paper Money

Many, including myself, are pointing out the emperor has no clothes. But only a few, such as Professor Antal Fekete, have the credentials of a bespoke tailor.

Professor Fekete's criticisms of the global economy are especially compelling because they are grounded in academic discipline and tradition. A mathematician by training (*professor emeritus University of Newfoundland*), Professor Fekete possesses that unique attribute of those whose interests spill over into adjacent areas and bring with them a fresh perspective to their new field.

We are fortunate Professor Fekete chose economics as his second love—and I, more than most, for it was the Professor that brought the Austrian School of Economics alive for me. Best known for the brilliant ground-breaking work of economic theorists Carl Menger, Eugene von Boem-Bawerk, Friedrich Hayek, and Ludwig von Mises etc., the Austrian School of Economics provides the ultimate counterpoint to today's financial tower of hubris, built on and out of paper and even now beginning to smolder and perhaps break out in flames.

In the spring of 2007, Professor Fekete reviewed my book, *How to Survive the Crisis and Prosper In The Process*, and was especially approving of the sections on money and credit. When I had presented my predictions of a coming economic collapse at a conference in March 2007, the prevailing opinion was that if I were right, then I was certainly among only a handful who believed a crisis was imminent—the gold community excepted.

What A Difference A Few Months Makes

In early May 2007, I wrote an article, *Subprime America Infects Asia and Europe*, predicting that America's defaulting subprime loans would soon surface in the portfolios of banks, insurance companies, and pension and hedge funds in Europe and Asia and consequently damage US financial markets in the eyes of global investors.

Summer 2007 subsequently confirmed my predictions that global financial markets were filled with speculative rot that had spread like the AIDS virus during the excessive financial rutting resulting from rumors of billion dollar bonuses being paid out by the Bally's and MGMs of international finance (Goldman Sachs, Bear Stearns, Lehman Bros, Citigroup, Morgan Stanley, Deutsche Bank, UBS, etc.).

Summer 2007 also brought something even more unexpected, an invitation from Professor Fekete to speak at Session II of Gold Standard University Live (GSUL) in Szombathely, Hungary. When I received Professor Fekete's invitation, I thought Session II was going to be in Birmingham, AL, home of the Full Moon BBQ; justly famous for its slow hickory smoked ribs and I was thinking of attending.

But with Professor Fekete's invitation, instead of BBQ ribs in Birmingham I was to dine on goulash in Hungary and was to come away with a radically different view of the unfolding crisis now spreading through global markets. For when I was in Hungary, the liquidity crisis in the world's banking system took a significant turn for the worse.

Midsummer Nightmare 2007

The Midsummer Nightmare of 2007 might be dismissed by some as a temporary crisis of confidence, a momentary shaking of investment bankers' confidence that is necessary in ascertaining risk and reward in today's markets.

Indeed, it would be so if confidence were not the very lynchpin of today's global financial system. Since gold has been replaced by paper money and IOUs are routinely accepted as investments, confidence has become the real currency in today's global banking system.

When A Confidence Game Is Being Run
Nothing Is More Important Than Confidence

What actually caused the central banks of the US, European Community, and Japan to offer liquidity to banks in August was their realization that the banks no longer trusted each other. When LIBOR, the interbank rate (the rate at which banks loan money to each other began to precipitously rise), the central banks knew a crisis of confidence was spreading. Banks were now reticent to loan money to each other, *sic* accept additional risk from other banks, at the usual rate.

Where Private Banks Fear To Tread
Central Banks Step In With Public Funds

For the moment, it appeared the central bank response had worked. In truth, it has only delayed the inevitable. The yield on three month US Treasuries yields plunged from 4.69 % to 2.51 % in a few short days as money managers feared commercial-backed paper assets were at risk and fled to the apparent security of government IOUs. The crisis was, and is now, beyond the ability of central bankers to fix or to contain.

We are not in the middle of a "correction" as many hope. We are at the end of the largest credit cycle in history, built on decades of credit and debt (from central banks) slowly replacing savings and productivity until the amount of credit and debt has overwhelmed the ability of producers and savers to service it. We are at the end of the cycle, not the middle, and endings, as we all know, are quite different than what one wishes.

There is no means of avoiding the final collapse of a boom brought about by credit (debt) expansion.

Ludwig von Mises

Those who traveled to Szombathely, Hungary to hear Professor Fekete were not the usual crowd one finds gathered around the water cooler swapping stock tips. They had come from as far-away as Australia, America, and as close as Austria, but all shared the feeling that a collapse of debt-based capital markets was approaching.

And as we listened to Professor Fekete lecture on “The Structure of Capital Markets” and “The Productivity of Capital versus Time Preference” etc., the global capital markets outside our lecture room were beginning to falter and stumble—the Midsummer Liquidity Nightmare of 2007 was fully underway.

When one runs with the crowd, commonly-held denials and beliefs are sufficient to justify dangerously complacent attitudes and opinions. At this time, America, and indeed the world, is clearly blind to what awaits it.

The idea of catastrophic economic change is today viewed as an improbable event, much as the collapse of the levees in New Orleans was viewed prior to 2005. After a week in Szombathely, Hungary, it is evident, however, that a coming economic collapse is as certain as was the collapse of New Orlean’s levees.

Will the Chickens on the Kentucky Colonel’s Farm Escape?

It is at times like this that one wonders if the citizens of Pompeii noticed any unusual volcanic activity prior to the deadly eruption of Vesuvius; and, if so, did they shrug it off as but another necessary release of volcanic pressure or did some heed its warnings and leave in time to escape the devastation.

Human nature rarely seems to change and if today is any indicator of the past, it is safe to assume Vesuvius did indeed erupt in the days prior to its catastrophic explosion; but that most ignored its warnings and perished; and, now, much like the citizens of Pompeii, America is about to get an unexpected “crash” course in economics and will suffer the consequences of its continuing denial. The past is indeed prologue if not heeded.

Professor Fekete has announced Session III of Gold Standard University Live will be held February 2008 in Bessemer, Al (near Birmingham and the Full Moon BBQ restaurant). For those interested, contact **GSUL@t-online.hu**

Darryl Robert Schoon
www.survivethecrisis.com
www.drschoon.com