Answering Your Questions

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Swiss Devalue the Franc tieing it to the Euro

WHAT NOW? CURRENCY WARS?

Just when you thought the Swiss franc would be the safe haven for capital in a tempest tossed financial sea, oops, here comes the dawn of a new age of competitive devaluation. The Swiss shocked the world by pegging its currency the franc to the euro. History repeats because people always respond in the same manner regardless of the generation at issue. Capital always rushes around from one currency to the next in time of economic instability. Because Switzerland is a small country, it cannot withstand a migration of capital on a grand scale. Excess capital inflow drives the value of a currency higher which results in raising the price of that nation's exports in theory reducing its exports and economic growth. This was one of the contributing factors to the Great Depression that led to protectionism for the lack of understanding about currency values and capital flows.

> "During this new stage of the depression,
> the refugee gold and the foreign government
> reserve deposits were constantly
> driven by fear hither and yon over the
> world. We were to see currencies demoralized
> and governments embarrassed as fear
> drove the gold from one country to another.
> In fact, there was a mass of gold and shortterm
> credit which behaved like a loose cannon
> on th e deck of the world in
> tempest-tossed era."
>
> *Herbert Hoover Memiors, 1952*
> *Greatest Bull Market In History, p354*

Effectively the Swiss devalued the franc to protect its economy renewing the post-Bretton Woods period of competitive devaluations where nations lowered their currency values against the dollar to improve their exports. This is bringing back memories of a forgotten period of currency wars.

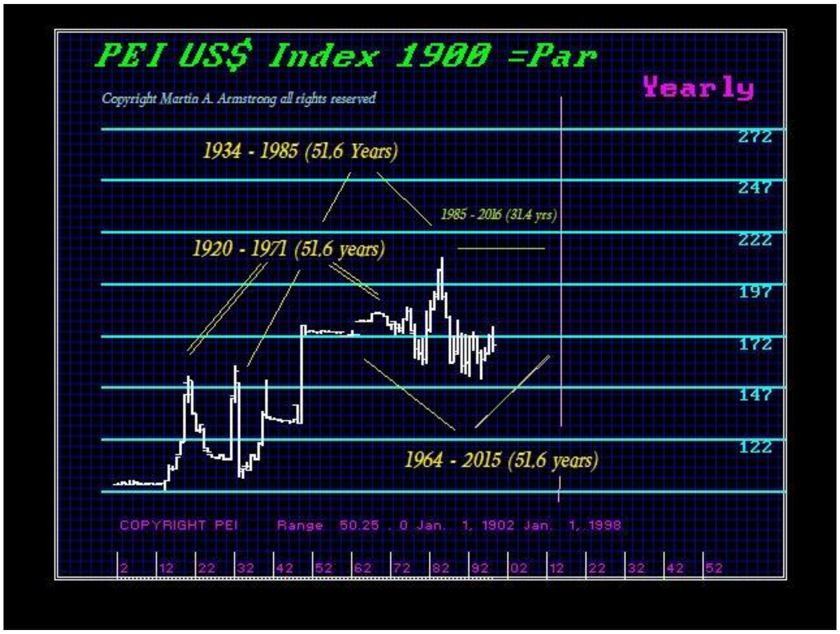
The Swiss franc has been rising against the euro and dollar as capital has feared sovereign defaults in Europe and others insist that the dollar will collapse under its debt burden. This capital migration to the Swiss has been hurting exports and tourism. Introducing fears of a new round of competitive currency devaluations pegging the franc against the euro, the Swiss have not merely shown the world the real rules of the game, but they have validated the very fears driving capital as Herbert Hoover described took place during the 1931 Sovereign Debt Crisis that has been conveniently left out of most history books on the subject of the Great Depression.

In a brilliant move to ward off excessive capital inflows, the Swiss National Bank devalued the franc announcing it was pledging to buy "***unlimited quantities***" of foreign currencies to force the value of the franc lower defeating the very safe-haven status capital had transformed the Swiss franc into during the period of a tempest-tossed financial chaos. The Swiss central bank warned that it would no longer allow one Swiss franc to be worth more than €0.83 (SFr1.20 to the euro). Fearing the Swiss franc could rise to par with the euro caused by the insanity of the ravages of the eurozone crisis as politicians are incapable of understanding what they have done in creating the euro, they devaluation the franc revealing one tool in the arsenal of central banks in a floating exchange rate system. The devaluation sent a shockwave through stunned currency traders mostly too young to have even known about the ***Age of Competitive Devaluations*** post-Bretton woods. The Swiss franc tumbled against other currencies as its intervention took place on a truly grand scale. The Swiss central bank has pledged to enforce a "***substantial and sustained weakening of the Swiss franc***" demonstrating that in this new age of floating currency post-1971, there are still anti-Free Market tools available. The Swiss central bank further announced its view that "***the current massive overvaluation of the Swiss franc poses an acute threat to the Swiss economy and carries the risk of a deflationary development.***" On this score they earn a AAA- for that statement. Yes, massive international capital inflows will raise the value of the currency reducing the competitiveness of the nation's exports and on the one hand create a deflationary trend. Excessive capital inflows will also drive down interest rates reducing fixed income increasing money supply. However, at the same time, if the excess capital remains there within the domestic economy, it will turn toward investment in tangible items and that will create inflation mixed with the counter-balance resulting in **STAGFLATION** where economic growth declines but prices can still rise.

The Swiss share market jumped about 5% and this is precisely what I have been warning about. Tangible assets will rise with the decline in the currency, not just gold. The Swiss franc settled around SFr1.2026 against the euro, after earlier trading at SFr1.1020. The long-term trend in the Swiss has not yet been reversed and thus the move is less likely to create a reversal in trend for Swiss exports when global consumer demand is declining. This move differs from the typical interventions under the G20 nonsense. The Swiss interest rates are already near zero and this has had no real affect deterring capital inflows largely due to the fact that it is not income but safety that is being sought right now to avoid loss of capital. Nevertheless, today's move gives further boost to **GOLD** where prices are established by a global free market and are not so easily manipulated on a sustainable basis.

The general talk is how intervention usually fails pointing to the attack on the British pound in 1992 and the Japanese yen fiasco. However, in the case of Britain, that was the **OVERVALUATION** of the pound on a peg within Europe precisely opposite of the Swiss intervention. To maintain that high value of the pound in 1992 would have **COST** untold sums of reserves. What the Swiss have done in devalue the franc and this is why the Swiss stock prices rose. Instead of having to pay out reserves as Britain faced in 1992, the Swiss risk attractive more foreign capital buying their assets that are reduced in value. This is more akin to when the British pound fell to $1.03 in 1985 and foreign capital poured into the country buying everything in sight as if it were on a one-day sale at Harrods.

In the case of Japan, the economy was imploding where at first foreign capital was fleeing Japan as assets became overprices. Japan was trying to support the Nikkei at unrealistically high prices and that led to Japanese banks and corporations holding on to assets expecting the government had the power to do as it pleased. Portfolios collapsed taking down banks and the whole intervention idea failed. Again, this was opposite of the problems facing Switzerland where Japan was trying to sustain high values and the Swiss are trying to suppress them. As the economy imploded, the Japanese were forced to repatriate cash to Japan driving the currency even higher ensuring a 26 year depression. Japan was trying to drink itself sober out of a serious stupor.



In neither case was there a viable economic trend in place to support the intervention looking at Britain or Japan. In the current situation, the driving factors are not domestic concerning Switzerland. This intervention is trying to deflect international capital flows. The devaluation was **BRILLIANT** insofar as it struck directly at the heart of the very issue driving the franc higher – a safe haven status. However, the risk is in making the Swiss assets cheaper that still serves to attract international capital inflows. There is a **SIGNIFICANT** different whereas when the **ASSETS** are undervalued, the inflows tend to be tangible investment as was the case with the take-over boom of the late 1980s. By simply allowing the Swiss franc to appreciate excessively caused by a safe-haven status, such capital is highly transient and can act much more like that "***loose cannon of the deck of the world in tempest-tossed era***" to quote Hoover. The devaluation of the franc does visit a penalty upon capital for parking in the franc hiding from the ravages of the global uncertainty.

The bottom line – this may be the factor that starts to support gold contrary to currency. It is not exclusively gold for the stocks rose in proportion to the decline of the franc there in Switzerland as well. This is the **<u>VIRTUAL INTANGIBLE INTERNATIONAL VALUE</u>** of all things that is subject to global arbitrage when capital flows like water to the best deal (Smith's ***Invisible Hand***). Hence, we were just given an important glimpse at what I have been warning about when capital rushes around the world as if it were a deck of a ship rushing from one side to the other. The British and the Japanese failures at intervention are not a lesson for the Swiss at this time. This is not a domestically driven phenomenon, but internationally driven one. That makes all the difference in addition to the fact that both Britain and Japan were trying to hold up unsustainable asset values whereas the Swiss are trying to suppress them.

As illustrated above, the currencies are being attracted toward 2015.75. We are headed into the eye of the greatest economic storm perhaps in modern history. The Swiss devaluation is a response to the call of the sirens as the central banks and governments are bound to the mast like Ulysses in danger of crashing upon the treacherous rocks that lie ahead because they fail to understand the economy.