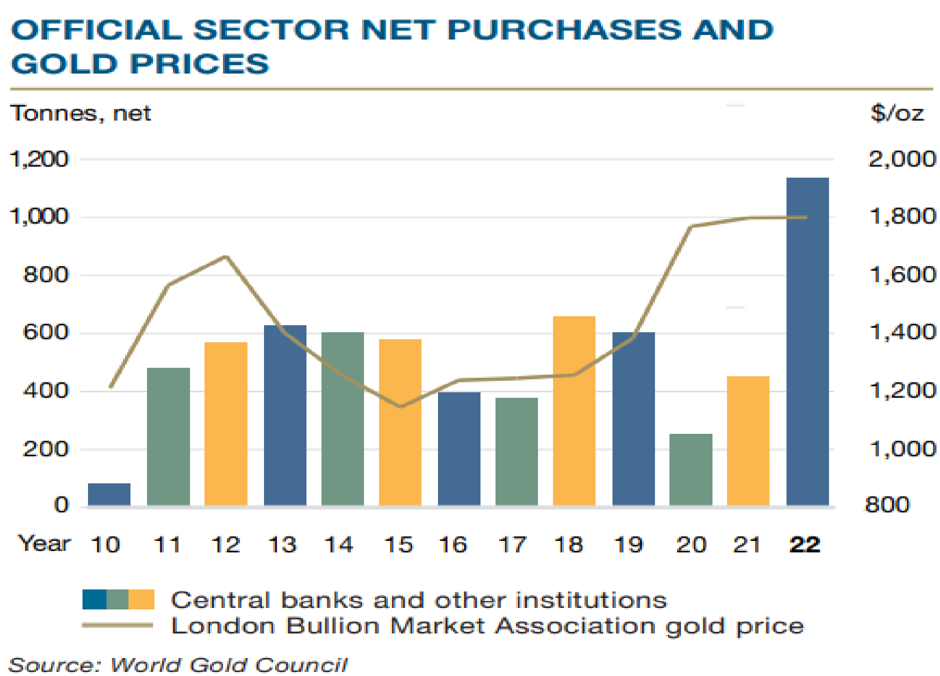
WILL THE UPCOMING BRICS+ MEETING IN AUGUST BECOME KNOWN AS BRETTON WOODS.2

Is it not ironic, that a new global trade currency linked to gold could emerge in the country which has produced 30% of all known refined gold, but with so much sweat and blood. While a new trading currency and possible investment currency could break the stranglehold of the $, linking it to gold is a bad idea.

The list of attendees and applicants going to the August meeting in South Africa grows by the week, and while the official figures are not yet in, it could be approaching 50. Included are some heavyweights such as Saudi Arabia, the United Arab Emirates, Turkey, Indonesia, and Mexico. If countries such as these were to join the BRICS+, its share of global GDP would be 50% bigger than the G7. That would represent the critical mass needed to introduce a new globally acceptable currency especially as they have a combined trade surplus as compared to a combined trade deficit for the G7 nations.

Two proposals are on the table, a currency linked to gold and a currency linked primarily to a basket of currencies. We will only examine the former whose prime mover is Russia. Why we have to take the former proposal seriously, flows from the observation that a number of BRIC countries are beginning to hoard gold, and if not hoarding, are now seeking to bring their gold home from the vaults located in the USA and the UK. "*Central bank purchases rose by over 150% year-over-year, representing the highest level of net purchases in over 50 years. The World Gold Council estimates that global central banks added 1,136 tonnes to their reserves during 2022, the 13th consecutive year of net purchases. During late 2022, China reported its first increases in gold reserves since 2019. This could have a strong positive impact going forward if purchases continue.*" *(*[Barrick Investor Relations website]) The graph below shows the growth in 2022.

Graph 1.



This movement of gold is due to the Ukraine war and the use of economic and financial sanctions against Russia by the USA. What really frightened countries was the freezing of Russian foreign assets held by its central bank amounting to $300 billion. Adding insult to illegal injury, the EU is now threatening to confiscate any interest on these holdings and hand it over to the Ukrainian government in the form of war reparations. It is this weaponizing of the Dollar that in the end may actually break the Dollar. No one likes a bully, and that applies to countries as well.

The failure of Bretton Woods.

Despite holding two thirds of global gold reserves and commanding 50% of Global GDP after the War, Bretton Woods was always going to end badly. As only the Dollar could be converted into gold it became the de facto reserve currency. But at the **arbitrary** convertible rate of $35 per ounce of gold, this convertibility was bound to have a limited lifespan. At $35 per ounce, the price of gold was never going to be high enough to encourage more gold production outside of South Africa. And with gold production limited by this $35 peg there was never going to be enough physical gold to clear trade imbalances.

Worse, with rising inflation increasing the cost price for producing gold, it meant that by the second half of the 1960s an increasing number of South African mines were becoming unprofitable. It simply meant that the value of gold was now elevated above its price when measured against a depreciating Dollar. With output falling and with a rising US balance of payments deficit, US gold reserves declined making the convertibility of the Dollar into gold impossible. The system collapsed in less than twenty years suggesting that any future gold-based system would be undesirable.

I wrote an earlier article which went into greater detail on the collapse of Bretton Woods. Here we will concentrate not on the 17 years leading up to its collapse but examine the behaviour of gold following its collapse, the period spanning the 48 years up to 2019. In the graph below there are two spikes in the gold price, the first following the final collapse of the gold peg in 1971, and the second the rise this century.

Graph 2. (Dollar Price of Gold)

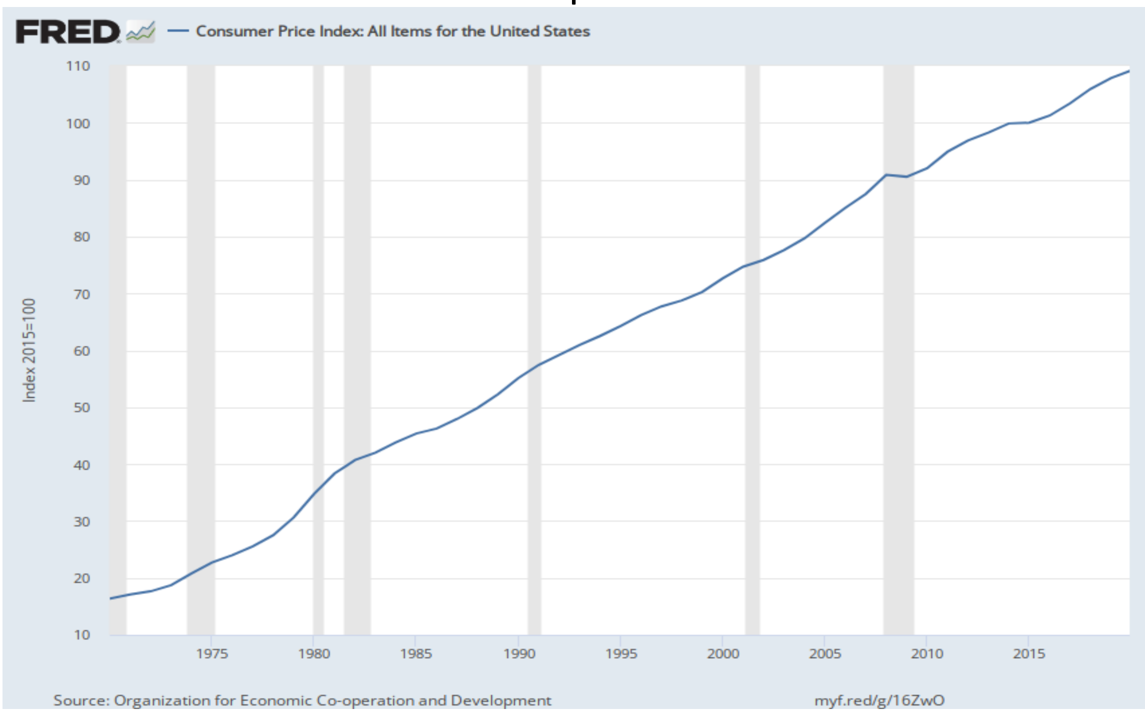
In absolute terms, the rise this century of close to $1,500 appears to be larger than in the 1970s, but what counts is the relative rise, and the rise in the 1970s amounted to 2,200% compares to the later rise of only 500%, or a quarter of the earlier rise. The ultimate goal here is to determine whether or not the movement in the gold price in any way correlates to the movement in prices post-1971. In the 1970s and 1980s it was quite fashionable amongst Marxists to present commodity prices in terms of gold showing that the upward prices in these commodities, particularly oil, matched that of gold resulting in the gold price of oil remaining constant. This was then used to demonstrate the depreciation of paper or token money, particularly the Dollar. This seeming association can be seen by matching the price of gold to the oil price in the 1970s.

Graph 3. (Oil Prices)

The oil price shot up from $24 to over $125 during the decade, or around 600%. Then moving into the period leading up to 2000 oil falls to an average of $70. Gold too retreats falling to an average of around $350 per ounce. But then the association weakens after that. While both prices peak in 2014 then fall back, gold unlike oil, goes on to reach new heights.

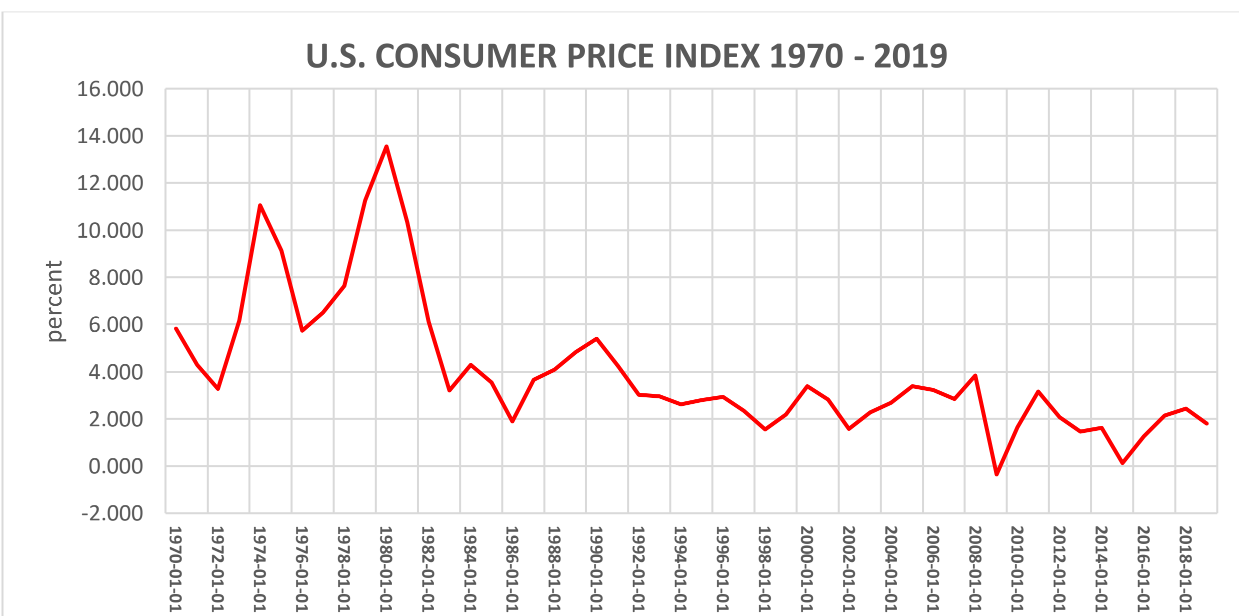
However we should not be consumed by the association between gold and oil as we are comparing like with like. Both are commodities subject to speculation and both are extremely sensitive to the business cycle. To avoid this it is more useful to compare gold to a basket of commodities, the best being the Consumer Price Index (CPI) or the Producer Price Index (PPI). Upon doing so, does the association continue? As the graph below shows, the short answer is no. The same would apply to the Producer Price Index only more so because it has been even more subdued than the Consumer Price Index.

Graph 4.



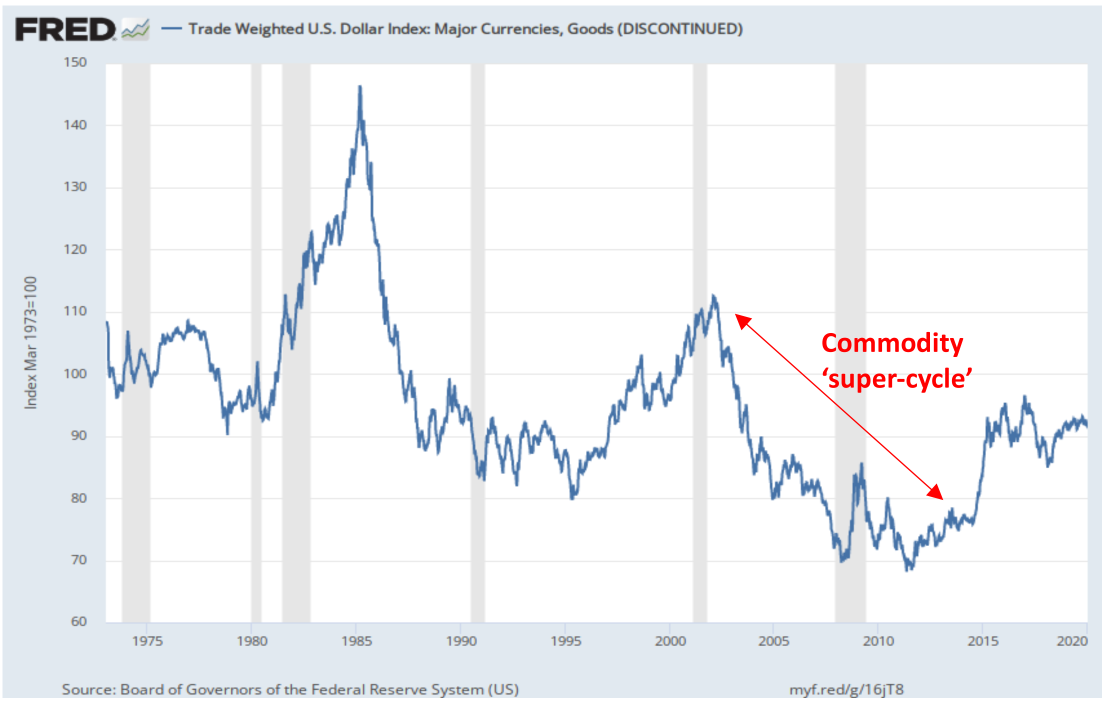
A more visual way to present this disassociation is to view monthly increases in the U.S. CPI. As we can see the inflationary wave of the 1970s was not repeated this century despite the rise in the gold price which left general price levels unaffected. This shows that specific events marked the difference; in the 1970s intense class conflict, this century class peace as well as the Chinese effect on global prices.

Graph 5.



A better fit between gold, oil and say copper prices is formed by the movement in the trade weighted exchange rate for the Dollar. Generally, being the reserve currency and with many commodities priced in Dollars, any rise in the exchange rate of the Dollar is associated with a fall in the price of these commodities everything else being equal, and conversely, any fall in the exchange rate results in a rise in the price of these globally traded commodities. As I began writing this article, the BLS reported that the CPI for June had fallen below expectations to 3% bringing down US interest rates and with it the Dollar, so if by reflex, the price of gold, copper and oil went up.

Graph 6.



Marx and money.

Here, is probably the most quoted observation made by Marx on the movement of prices. *"A general rise in the prices of commodities can result only, either from a rise in their values — the value of money remaining constant — or from a fall in the value of money, the values of commodities remaining constant. On the other hand, a general fall in prices can result only, either from a fall in the values of commodities — the value of money remaining constant — or from a rise in the value of money, the values of commodities remaining constant."* (Karl Marx, Volume 1, Chapter 3, Section 1.)

Of course it must be recognised that Marx is here dealing with gold as the money material in the abstract. Observed more concretely, there is no mechanical relationship. Over the course of the business cycle prices change even though their costs of production and that of gold may not change. During the down phases when prices fall below values because a part of the value produced cannot be realised through sale, gold is hoarded, and during the up phases when prices rise above values, gold hoards diminish as circulation increases. Therefore it is correct to say that over the course of the business or 'industrial cycle' as Marx called it, once the plusses and minuses cancel each other out, changes to prices can only result from changes to the values of commodities including gold.

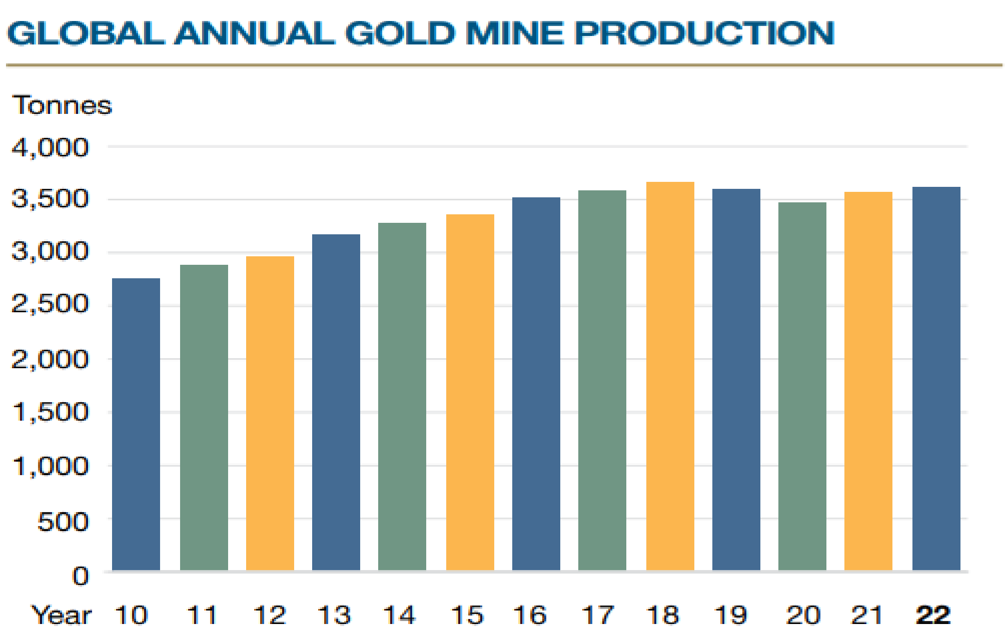
As long as a gold standard is in place, state currency or money is disciplined. If the state currency falls below convertibility, it is sold and gold is bought, and if the state currency rises above convertibility, gold is sold and the currency is bought. Thus demand and supply regulates convertibility. This was especially true for foreign trade when any trade surplus led to the accumulation of gold reserves while a deficit led to the loss of gold reserves and therefore the tightening of internal monetary conditions.

Will the proposal to make the new currency convertible into gold be confirmed?. Gold lovers hope so and have been doing the sums. *"Today, the gold price is too low to allow markets to clear, because assets are over-valued vis-à-vis gold," he said. "According to my calculations, you're talking about something in the region of **$50,000** per ounce being [reasonable] if you go back to a gold-backed international monetary system."* (My emphasis.) Actually it has little to do with assets and more to do with the sum of value in circulation within countries and particularly between countries.

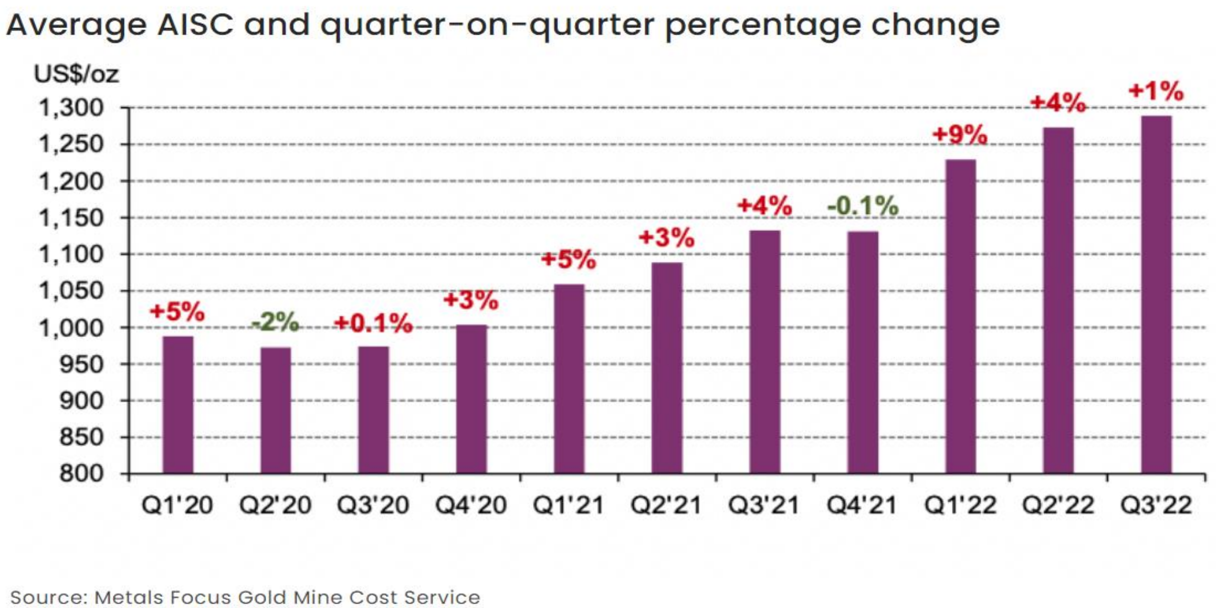
$50,000, were that to apply, the following would happen, (a) the queues outside pawnbrokers and gold dealers would stretch around the block as pundits cashed in their golden trinkets, (b) the queues outside dentists would also stretch around the block as patients waited to have their gold crowns replaced with porcelain, (c) pedestrians would have to walk around wearing gloves to prevent their ring fingers being bitten off by would-be muggers, (d) the stock and bond markets would collapse as money was withdrawn to buy gold, and (e), speculators would go on an arbitrage round trip, first selling Dollars to buy the new currency in order to buy gold to then sell this gold back for Dollars, driving up the new currency and driving down the exchange rate for the Dollar.

The fact is there was not enough gold during the realm of Bretton Woods and there is certainly not enough gold today, especially given that recent gold production has plateaued. This plateauing can be seen in Graph 7. This is primarily due to rising cost prices which can be viewed in Graph 8.

Graph 7.



Graph 8.



(Both Graphs sourced from Barrick Investor Relations website)

The 'AISC' or *All-in Sustaining* cost price differs from the current cash cost price. "*AISC is an extension of currently existing 'cash cost' metrics which includes sustainable production costs too. AISC includes all the varying costs incurred in gold production over the mine's life-cycle."* The AISC is a better measure as it represents the estimate over the life of the mine itself rather than current conditions, bearing in mind that over the course of the life of the mine, as the richer seams are exhausted costs go up. Thus unless the gold price shoots up in whatever currency, production is unlikely to increase. *Barrick* the world's largest gold producer and likely its most profitable, had a rate of return in 2022 based on operating profits over fixed assets plus inventory of 12.8%, reducing to 7.2% for pretax profits. This is at the lower end of average for the whole economy thus not making the gold industry a sought-after destination for additional investment. (Source: Barrick Investor Relations website page 171)

Discussion.

There are already a number of mechanisms in place which can accelerate the introduction of this new digital currency should the BRICS+ decide to go ahead. This Fortune Magazine article has a useful history of the economic mechanisms set in place by the BRICS. "*In 2010, the BRICS Interbank Cooperation Mechanism was launched to facilitate cross-border payments between BRICS banks in local currencies. BRICS nations have been developing "BRICS pay" – a payment system for transactions among the BRICS without having to convert local currency into Dollars,"*

This article provides a useful argument that a joint currency used to finance and clear foreign trade between the BRICS+ countries is feasible because overall the BRICS countries have a positive foreign trade balance. "*In 2022, as a whole, the BRICS ran a trade surplus, also known as a balance of payments surplus, of $387 billion – mostly thanks to China."* This is important because the issue of an international currency is not only about lubricating international trade and investment but preventing the imbalances in trade and investment ripping that currency apart.

Thus the history of how best to moderate imbalances in trade and inflation is fraught with counterposing arguments all of which demonstrates how unmanageable private property relations on a grand scale are. [This article] has a useful history of these discussions including Keynes' *Bancor* which was still-born because the US had the power to elevate the Dollar above all other currencies making it the fulcrum of the global financial system.

Similarly there has been a history of discussion on how best to introduce a new BRICS+ currency. Initially the proposal centred on a basket of commodities. Then this progressed to the *Valdai Club* where national currencies replaced the basket of commodities. "*the idea was to create an SDR-type currency basket composed of BRICS countries' national currencies as well as potentially some of the other currencies of BRICS+ circle economies. The choice of BRICS national currencies was due to the fact that these were the among the most liquid currencies across emerging markets. The name for the new reserve currency — R5 or R5+ — was based on the first letters of the BRICS currencies all of which begin with the letter R (real, ruble, rupee, renminbi, rand).*

Latterly, linking these currencies to gold has been floated. Of equal importance is the status of this currency, aka that it be limited to clearing trade but one which avoids becoming a reserve currency as this would require China opening up its bond and financial markets. It also limits the scale of any financial body brought into being to regulate this currency.

China does not have the power and influence over the world capitalist economy that the USA had after the War both productively, financially and militarily. Therefore it is likely that China will adopt a more collaborative approach to this currency. For this reason the new currency is likely to be based on a basket of currencies comprising the members of the BRICS+ with weightings based on the size of their economies and trade. If the Yuan ends up playing a non-pivotal role, this will make the link to gold more important. Much less important is the form this currency would take. This is the accepted summary to date. "*It would be a digital currency on a permissioned ledger maintained by a new BRICS+ financial institution with encrypted message traffic to record payments due or owing by participating parties. (This is not a cryptocurrency because it is not decentralized, not maintained on a blockchain and not open to all parties without approval.)"*

Introducing a new currency is not an overnight event. We only have to recall the extended gestation period of the Euro which took 20 years, beginning in 1979, when the European Monetary System (EMS) was first created fixing exchange rates via the European Currency Unit (ECU). The ECU remained an accounting artifact intended to stabilise exchange rates and moderate inflation, but was itself not a real currency.

Despite my extensive research, much of what has been written about the prospective new digital currency remains speculative. To date I have not come across any official proposals particularly those which will be forwarded from Beijing. The most likely outcome will be a currency limited to facilitating trade and non-financial investment, based on a basket of currencies that extend beyond that of the original BRICS and linked through some mechanism to gold. Beyond that it is difficult to say any more, either about the currency or the institutions needed to regulate it and provide the necessary finance to make it work. That said, we need to remain observant about what is likely to be this century's most important monetary development.

The Ukraine War and China's improvement in productive techniques.

The Ukrainian war, in so far as it has led to the defeat of NATO's ambitions, the burning of western weapons, and the humiliation of Zelensky on the first day of the NATO summit in Vilnius, has given more confidence and authority to the upcoming meeting in South Africa. This military development has weakened the collective west, undermined a uni-polar world, and accelerated the emergence of a bi-polar world which is likely to be anointed with a new currency in under two months.

For this pole to function free of duress, it needs to be based on an independent economic architecture, which depends on China's ability to compete with Western Technology. The USA has not only weaponised the Dollar but with Europe, Japan, and South Korea in tow, it has weaponised High Tech. China's ascent up the tech ladder will deprive the West of this weapon. In the end, the strength and vitality of the US Dollar depends primarily on the US's technical prowess which allows it to straddle the commanding heights of the global value chain. Once this diminishes the Dollar will weaken and the new currency will go from strength to strength.

Readers of this blog will know that in evaluating China's technical rise, I have focused on jet engines and lithography machines as they are the two most complex and challenging of all engineering projects. In the case of jet engines the customer for these items was the Chinese State. For this reason Chinese aero engineers and companies were continuously supported and allowed to stumble for 30 years trying to build modern jet engines, culminating in the ws-15 which is on par with the best of the west and now powers the formidable Chinese jet fighters the J-20 and soon the J-35 fighter.

The same cannot be said with microchips where the customer was the market. Here Chinese companies shunned Chinese producers as their chips were inferior and slower. The result, with few exceptions, was a Chinese chip industry held back because leading Chinese corporations sourced western chips and technology. That is why China, despite some calling it state planned or even Socialist, was caught with its pants down in 2018 when Trump announced the first of what was to be an avalanche of embargoes against Chinese companies. It has taken five years for China to begin to catch up. The latest breakthrough has been Huawei's new locally produced 5G Kirin chip, as well as strong evidence that China will start installing SMEE's new DUV lithography machines in its own FABs by year end, thereby overcoming any western dependencies in this vital stage of the production process. (The evidence is also now accumulating how damaging the tech war has been on Western Corporations helping drive down their profits. For example the world's largest chip and phone provider, *Samsung*, saw its operating profits plunge 96% in the latest quarter. Serves them right for tying their wagon to a shoeless horse.)

Conclusion.

The weaponization of the Dollar has made inevitable the emergence of a competitive international currency, which over time will whittle away at US Dollar hegemony. Its emergence will mark the definitive birth of a bi-polar world overcoming the remaining legacies inherited from the Second World War. We await the historical month of August.

Brian Green, 14th July 2023.