Russia and the Failures of the Western Financial System

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2014 was a year of posturing. The U.S. "postured" by trying to lure Mr. Putin and Russia into a war. First it was over Syria and then later over Ukraine. The Russians postured by not taking the bait and buying time. Yes, Russia has suffered with a devaluing currency, lower oil revenues, and an economy running on less than eight cylinders. China has stayed out of the public spotlight during this period but privately stood behind Russia, I will explain this a bit later.

I mentioned "buying time", by necessity, Russia has done this as a tactic I believe to slow down the implosion of the Western financial system. On the face of it, I know this sounds ridiculous …why would Russia want to prolong the Western system. The answer is very simple, they, nor China were ready. They may not even be fully "ready" now but at least the financial infrastructure is in place for when it does happen.

Over the past year and as a result of sanctions by the U.S., Russia set up their own alternative to the SWIFT clearing system. This was being tested for the last two weeks. The original start date was May 15, 2015, this seems to have been advanced by months as the system may go live without any notice or if Russia were to be isolated from the SWIFT system. The important things I see from this are basically threefold. First, the U.S. has not had enough political capital to kick Russia out as several European nations refused to go this route (it's cold and they need Russia's nat gas). Secondly and maybe more importantly, SWIFT can no longer be held as a potential hammer over the head of Russia since they have an alternative. Lastly, the alternative clearing system will at a minimum bleed liquidity and thus more velocity out of the West. In a worse case scenario, the new clearing system may become very attractive and lure a majority or even a supermajority of trade participants to abandon the West's game. Were this to result, the dollar will lose its usefulness and thus its de facto reserve currency status.

We also heard of another announcement over the holidays between Russia and China. They performed "currency forwards and swaps"

http://thebricspost.com/china-launching-forwards-swaps-with-ruble/#.VJ1ko_8riE .

This was done I believe to support Russia and her ruble more than any other reason. You will notice the ruble immediately strengthened nearly 40% on this announcement. The sanctions along with "Mr. Obama" cutting the price of oil in half will not cause Russia to default as they have nearly as much cash foreign reserves as they do debt outstanding. This is very important, Russia has a pristine balance sheet where their debt is only 14% of GDP, compared to the West's understated debt amounts equaling 100% or more of GDP.

I want to mention the recent explosive move higher in the dollar. It has rallied nearly 15% in six months, and nearly 10% of this in just the last two month. This I believe is the result of the dollar carry trade unwinding. Many commodities including oil were "carried" by borrowing dollars. This was a synthetic short position in the dollar. As the commodities (oil) imploded in price, traders were forced by margin calls to exit positions. The borrowed (shorted) dollars were paid back (covered) and has caused the rally in the dollar.

On Friday, the first trading day of the year, "something broke…somewhere". For the dollar to move nearly a full one percent higher in a single day is not only a symptom but also a financial killer. The IMF claims there is a $9 trillion carry trade in the dollar. Just one percent of this amount, the carry trade (not to mention dollar based derivatives in the $100's of trillions), amounts to $90 billion! Let me put this in perspective for you. On Friday alone, "someone made" $90 billion and "someone" also lost $90 billion. This means there will be huge margin calls for Monday morning.

For a little more perspective as long as we are speaking of mas o menos $100 billion, the Treasury went another $100 billion in debt on Dec. 31st.. This number of $100 billion also fits nicely into the gold market, this happens to be just about the amount of gold which is produced from ALL of the worlds mines in a FULL YEAR! Do you see the comparison here? The Treasury borrowed in just one day, an amount equal to annual global gold production …at current prices. We should also be seeing margin movement of about this much on Monday because of the FOREX price action on Friday.

Lastly, it needs to be pointed out that gold was the number two "currency" on the planet last year as it dropped just over 1% versus the dollar. This means what exactly? It means gold rallied just about as hard in foreign currency terms as the dollar did! Oh, and let's not forget about the multi thousand ton "paper anvil" the COMEX has thrown around the neck of gold. Even with "instantly and freely" created paper supply of gold, the price has held over the last year to trade at near parity with the dollar. Now that volatility has and is exploding in nearly all asset classes, we may soon see why the CME has instituted "collars" on the precious metals.

Volatility in today's world is a systemic killer, let me explain this before finishing.

Looking at volatility moves in the dollar, oil and many stock and bond markets leads me to believe there are huge margin calls and unfunded positions behind the scenes. Some very strange events have taken place, a perfect example would be 10 yr. Spanish bonds issued by an obvious bankrupt trading under 1.5%. The dollar move on FOREX these past weeks tells me one of two things, either something blew up …or the move itself blew someone up. The action we have witnessed is not normal and certainly not sustainable because of the derivative losses created. When you add the puzzle piece of what Russia and China are doing together, it tells me they are "readying" for the derivative daisy chain to break.

China is preparing the yuan to ascend to reserve currency status while Russia is preparing the clearing infrastructure mechanism. [http://www.bloombergview.com/-articles/2014-12-25/china-steps-in-as-worlds-new-bank](http://www.bloombergview.com/articles/2014-12-25/china-steps-in-as-worlds-new-bank)

As for the West, "bail ins" have been legislated into law over the last year for a reason. They know "it" is coming. The latest act of Congress which saddles FDIC with broken banks busted by derivatives should also tell you something …they know it's coming!

Laugh this off if you like, whether the West is ready or not, the East has been preparing and will be.

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Bill Holter writes and is partnered with Jim Sinclair at the newly formed Holter/Sinclair collaboration. Prior, he wrote for Miles Franklin from 2012-15. Bill worked as a retail stockbroker for 23 years, including 12 as a branch manager at A.G. Edwards. He left Wall Street in late 2006 to avoid potential liabilities related to management of paper assets. In retirement he and his family moved to Costa Rica where he lived until 2011 when he moved back to the United States. Bill was a well-known contributor to the Gold Anti-Trust Action Committee (GATA) commentaries from 2007-present.

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