Beneath the Surface

July 2024

SIGNET

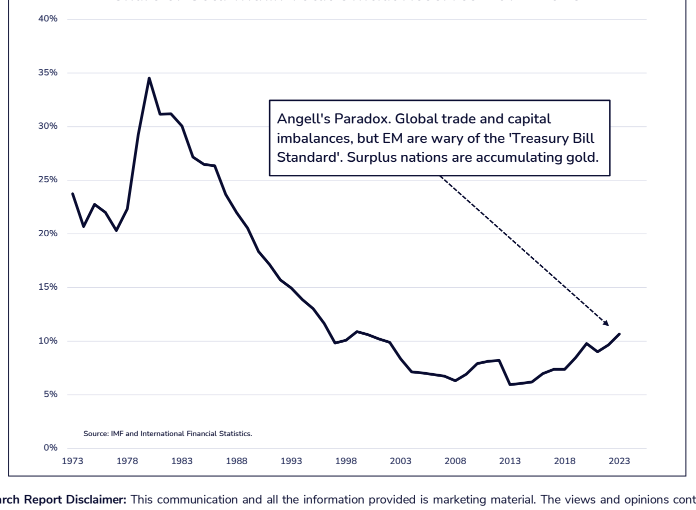
Angell's Paradox

- Seizing Russia's foreign exchange reserves over the last two years is a potentially significant, but underappreciated, mistake made by the US led coalition. If the West is perceived to be failing to uphold the rule of law, capital at risk is less likely to be secured within the West's central or commercial banking system. It will be repatriated to prevent seizure, and not as Treasury Bills. Sir Normal Angell, writing in The Great Illusion (1909), believed that wealth in a modern world would be founded upon credit and commercial contract. If these contracts are abused, it is ultimately the abuser's debt-based status quo that is jeopardised. It became known as Angell's paradox. As predicted by the paradox, we are now witnessing a re-energised interest for EM economic partnerships, based around the BRICS organisation. This should be seen as a strategic move to reduce dependence on western-led financial institutions.

- Because of this dynamic, we are more skeptical of the recent press reports stating that China's PBOC has stopped buying gold. Gold is viewed as a hedge against economic and geopolitical risks, and central bank gold holdings have been rising ever since the Global Financial Crisis. Specifically, reserve managers in emerging markets have increased their share of reserves held in gold, at the expense of US Treasury Bills, in response to political and sanctions risk. This has gained further traction since 2022. Gold's share of official international reserve assets, based on the market valuation, has declined from c.30% in the 1970s and 80s to 10% now, but it appears as if the downward trend has changed (chart, below left). The change to gold's status, as a growing reserve asset, is being led by EM central banks and the rise of the East in a new multipolar world. How far could this go? The IMF claimed, in 2023, that gold represented c.60% of the official reserves of the US and c.50% for the Euro area. Contrast this with Russia at 20%, China at 3%, India at 7% and Saudi Arabia at 4%. We view precious metals and gold favourably, especially on price weakness. Expect the Federal Reserve to continue backstopping the Treasury market and the banking system.

- US savings. We highlighted the drawdown in the Covid-derived 'excess' savings in 2023, which has been supporting US consumption in recent years. The conspicuous consumption continues, but without the Covid-related stimulus. The US personal saving rate, as a percentage of disposable personal income, has now fallen to 3.6% (annualised, below right). This is worth highlighting, especially since this blended savings rate will disguise the demographic bifurcation that exists. To put the 3.6% rate into context, it has averaged 3.9% since Jan 2022 and averaged 6.1% from Apr 2009 until Dec 2019. The current rate of savings is at least better than the average rate leading into the GFC (2.6% from Jan 2006-Jan 2008). Of course, if we look back further in time the average savings rate was noticeably higher. From Apr 1959 to Apr 1999 the US personal saving rate averaged 10.1%; an era of less debt and higher nominal interest rates (the Fed funds rate averaged 6.5% then). The recent drawdown in savings was channeled into homes, the equity market and discretionary consumption. Savings appear to be quite exhausted, and this is likely to have an impact on consumption, which we expect to cool. Consumers and markets may become more fragile – to understand what this all means for asset allocation and investment selection, please reach out.

Share of Gold within Total Official Reserves: 1971-2023



US Personal Saving Rate (%): 2007-2024