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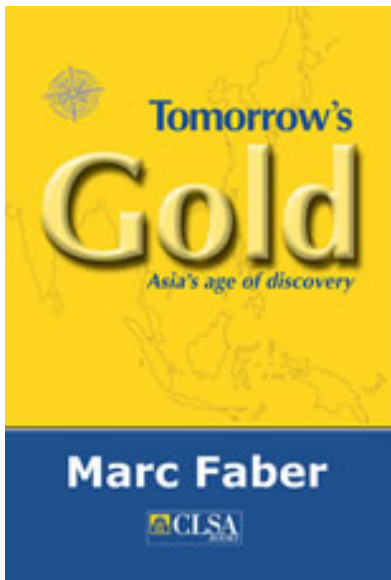
TRANSCRIPTION OF INTERVIEW

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Marc Faber, PhD, Editor & Author

Tomorrow's Gold - Asia's Age of Discovery

Editor's Note: We have edited the interview in this transcription for clarity and readability. The original real audio interview may be heard on Dr. Faber's [Ask The Expert](#) page.



JIM PUPLAVA: Joining me on the program this week is Dr. Marc Faber. He is editor of *The Boom, Doom & Gloom Report*. He is also the author of a new book called, *Tomorrow's Gold—Asia's Age of Discovery*. Dr. Faber studied economics at the University of Zurich and at the age of 24, obtained a PhD in Economics magna cum laude. Between 1970 and 1978 Dr. Faber worked for White Weld & Company. Since 1973 he has lived in Hong Kong. In June in 1990, he set up his own business, Marc Faber Limited, which acts as an investment advisor, a fund manager and broker/dealer. Dr. Faber publishes a widely read monthly investment newsletter, *The Boom, Doom & Gloom Report*.

Doctor, let's talk about your new book, *Tomorrow's Gold*. In the 1990s, a lot of economists, analysts and politicians proclaimed that the business cycle was dead. In fact, as we have seen, we had a booming economy in America, we were in a new era, a new paradigm, but a lot of this is attributed to too much credit, which has fuelled a speculative boom, and which is behind much of today's current economic malaise.

DR. MARC FABER: Thank you very much for having me on your program. This is absolutely correct, that in the 1990s, debt growth vastly exceeded economic growth in nominal terms. Not just in the US, but also outside the United States. What happened is that the Debt to GDP Ratio increased everywhere very substantially. In the United States, the nominal GDP between 1997 and 2001 increased by \$1.7 trillion, at the same time, non-financial, non-federal debt increased by \$4.5 trillion and financial by \$3.9 trillion. In other words, in order to generate one dollar of GDP growth, you created \$4.8 dollars of new debt.



JIM PUPLAVA: Let's talk about the key or central thesis behind *Tomorrow's Gold*. What are the central elements that you are writing about in this book?

DR. FABER: I think that in the late 1990s, people became upset with watching the stock market and the financial markets in general on a day by day or minute by minute basis and they were glued on their Bloomberg machines, or on the on-line trading accounts, or on CNBC. Whereas my major thing is that basically in the last 30 years, with very few investments decisions, you could have done very well. You could have bought gold at \$34 an ounce in 1970 and at the same time, oil for \$1.30 per barrel. You could have gone on a holiday and sold it in 1980, gold at \$850, and oil at close to \$50.00 a barrel. You could have worked for one week and figured out investing in Japan as the best alternative. Then you could have bought Japanese stocks and sold them in 1990, ten years later with a seven-fold gain. Then, you could have worked another week and decided that everyone was optimistic in Asia, but decided there was an under-valuation in US equities. And then you could have bought the S&P 500 or ideally the NASDAQ and sold it again ten years later in March 2000, with a gain of 10-15 fold. In other words, an investor who is seriously eager to make money, he doesn't have to watch the markets everyday. He just has to make once in a while, a good investment decision on the trends that will last for a number of years.

JIM PUPLAVA: You know there is a similarity to this viewpoint to those investment views of Warren Buffett. Warren Buffett seeks good investment opportunities and has the insight to buy low, and hold for long periods of time, which has made him one of the wealthiest men in the world.

DR. FABER: I think that is definitely correct. The problem is, if I get the clients today and let's say I buy in something. The markets around the world rise by 20% and his investment doesn't go up in a year's time. He would say, "You bought the wrong thing." People are very short-term oriented at this time. I bought Taiwanese and South Korean stocks in 1978, but they didn't move up until 1985 at the time when the US markets, between 1982 and 1985 have doubled and Japan had tripled. Well, an investor would have said, "Well, Marc, you are totally wrong about investing in these countries. Everything is moving up, except your stocks."

The fact is that between 1985 and 1990 the Taiwanese market was up 25 times and the South Korean market up 10 times. In other words, as an investor, people have to learn to be patient—more so than they have been. In other words, they give money to hedge funds and they expect the hedge funds to be up 10% in three months. They buy stocks on the recommendation of a broker and they expect it to be up 20% in six months. This doesn't happen in the long run. It may happen from time to time. But long-term, the people I know who became rich, the rich families in the world, they usually had long-term investment horizons.

JIM PUPLAVA: This is surprising, not only in terms of your perspective on this and recognizing that is how real wealth is built, but I am always fascinated, Doctor, that many have not studied this principle, developed also by Warren Buffett. How he applies this is with patience. During the tech boom, he was criticized that he had lost his touch, but he still remains one of the wealthiest men in the world. I want to move on to your perspective on economics.

DR. FABER: May I interrupt for a moment? I think it is very important for you to understand as an investor, that if you look at Michael Schumacher, he drives a car the way you and I cannot drive. The same way there are some professionals in the investment field that can make a lot of money by trading securities because they have superior knowledge and superior skills. Now, nobody would try to drive his car the way Michael Shumaker drives, but in the investment world, 90% of the people think they can be as good as George Soros, or Julian Robertson and all the superstars. We have to distinguish between very few people who are superstars, like Andre Agassi in tennis, Michael Schumacher in driving and Warren Buffett, George Soros, or Julian Robertson in investing. The average person cannot perform as well as these people. Therefore, for the average person, preservation of capital should be far more important than aiming at making 100% per annum. As a result of that, I would say that if I look around the world, most people that invested in real estate and didn't borrow money, they have done relatively well, because a lot of wealth is concentrated in real estate, simply because these people didn't do anything more stupid.

JIM PUPLAVA: You make a very valid point and I think it is something that is often lost. Going back to your theme, if you can discover a simple theme, stay with it and hold onto it, you would have made a lot more money. I just want to relate that to many of our listeners, who think back to the tech bubble in the 1990s. Had you bought tech stocks in 1990, 1991 and 1992, whether it was Dell, Intel, Microsoft, even a Cisco, you would have done far better had you sat and held them for the next decade than you would have by trading in them.

DR. FABER: Yes, exactly.

JIM PUPLAVA: I want to move on to your views or your perspective on economics. You approach the framework of analysis of looking at economies from the Austrian School of thought. I wonder if you might explain that.

DR. FABER: First of all, I think it is unfortunate that in the last 10 to 20 years, the world has kind of moved to the American soul. That is if you ease monetary conditions, if you print money, you can solve all the problems of the world. If that was mainly true, Latin America would have become the richest continent on earth simply because they have been masters at printing money and at creating at the result of that hyperinflation. By printing money, you don't generate economic growth. Temporarily, you can generate continuation of spending patterns.

I will give an example. Since January 3, 2001, the Fed Fund rates were cut massively and the Federal Reserve eased monetary conditions massively. We had very strong debt growth. What this meant was that spending and borrowing in the US went up, but industrial production was flat. Industrial production increased in China, Vietnam and other Asian countries. In China, industrial production was up 19% last year. Exports were up 22%.

In other words, what you do in America is you borrow more money, you spend more money, but the production is somewhere else. And as a result of that, we have growing trade and currency account deficits. In other words, there is a shift of wealth to the Far East as a result of these qualities. In the Austrian School of Economy, they look at the world differently. They recognize that there are business cycles. If there is a new invention, if there is a new discovery of a mine, if there are innovations, then it brings about a capital spending boom, because everyone wants to capitalize on the promised higher profit opportunity. Therefore, you get into boom conditions, which leads to over-capacity, which leads to a price collapse as a result of the profit expectations being disappointed. That is the natural downturn following a boom. The downturn is very important because it cleans out the excesses of the upturn.

But in the American school, the downturn is postponed through monetary measure. In other words, the capacity that never gets cut back, because if you ease massively, you don't create an environment of the survival of the fittest, but you create an environment of the survival of the weakest. Even the weak market participants, continue to produce, especially if they go into Chapter 11, because then they don't have to pay any debt payments, and therefore, they can undercut the other. That is why the American school, in my opinion, in the current situation, has policies that will then lead to a prolonged recession at the later stage.

JIM PUPLAVA: Would you think this kind of thinking persists on Washington and Wall Street? One exercise I like to go through at the beginning of the year is to take all the investments predictions and economic predictions that all the major magazines and publications publish. Most of the time they are wrong. Wall Street has been predicting a second-half recovery in the US for the fourth consecutive year.

DR. FABER: It also depends how you define economic growth. I would say the interpretation of statistics is very difficult. Let's say you take a computer manufacturer. They sell this year 1,000 computers at \$1,000. In other words, the turnover is a million dollars. And the next year, they sell 2,000 computers at \$500 because prices eased. How do you measure growth? In dollar terms, 2,000 computers at \$500 are equal to 1,000 computers at \$1,000. In other words, sales growth is zero. That is essentially measured in GDP figures. In terms of units, you have doubled the output and therefore there has been, in unit terms, 100% increase. How do you measure that? So, the measurement of statistics is very difficult, equally.

If you have an economy, where suddenly the central bank sends a check to every citizen of say \$10,000, this of course leads to higher spending, temporarily. All I want to say is there are two different types of growth. Growth that is generated by additional borrowing that exceeds nominal GDP growth—a growth that in my opinion is not sustainable in the long run. Or, you have growth generated by people having a high savings rate, and savings are then channeled into investments and into the construction of additional factories, buildings, highways and so-forth. That makes the economy more efficient in the production of goods and services. In the case of the US, the problem is all the growth in the last few years was generated by additional borrowing.

JIM PUPLAVA: You quote in your book from Friedrich Hayek, who made the statement, "The more the State plans, the more difficult planning becomes for the individual." Why is that?

DR. FABER: I think if you look at the history of the last 100 years, what is very clear is the Socialist and Communist ideology where everything is owned by the State. The State plans how much is being produced, how much is being consumed, and how goods and services are being distributed within the economic system. I may add that planning economies have all the tools available to do that properly, and yet they miserably failed.

In the Western systems, we have the market economy and the capitalistic systems, which work reasonably well. In the last 15-20 years, the view has come up that the Central Bank can steer the economy forward and backward, through monetary means. Unlike the planning economies of the Socialist and Communist countries, they only have one tool available. Yet people believe in Alan Greenspan, the way they believe as Christians in Jesus Christ, as Muslims in Mohammad. This is wrong. The power of the Central Bank is very limited. In my opinion, the world would be better off if there were no Central Banks around.

JIM PUPLAVA: That leads me to my next question. I wonder if you might explain your huge pool of money sloshing around the globe, your *bowl theory of credit creation*.

DR. FABER: I think that obviously, as long as you have Central Banks around the world, and as long as they believe that problems can be solved by printing money, you will have a continued flow of money into the world. This money pours into the world and will of course create some kind of inflation somewhere. What the Central Banks don't control is that once the money flows into the world, or into an economic system like the US, where does it flow once it hits the ground. In other words, between 1970-1980, the money boosts its commodity prices and real estate. Between 1980 and 1990, it boosts its Japanese stocks and Asian Stock market. After 1990, it boosts, principally the stock market of Western industrialized countries such as the US and Western Europe.



What is interesting is over the last three years since March 2000, the money that flowed into the world did no longer go into stocks, but it boosted hard assets. In particular, as you well know, real estate has been strong in the US for the last three years; equally it has been strong in the United Kingdom. This is unusual that three years into a bear market in equities, property prices have been this strong. Equally, we have very strong commodity markets. Coffee in the last 12 months is up 130%, propane 110%, natural gas 104%, oil 68%, cotton 67%, and gold is up 33% from its low in April 2001, gold is up actually over

40%. What you are seeing is a shift out of financial assets into hard assets. I think this shift is for real and will continue for a number of years for a variety of reasons.

JIM PUPLAVA: Now, relating to that, you point out to this shift of money flowing into real estate in the United States. There is even more to that as I see it. We have not only have another bubble emerging in real estate, but we also have one in mortgage and mortgage financing, which is feeding into consumption.

I wonder if you might comment on that, because one of the aspects that strikes me about this last recession in the US, unlike in 1990 and 1991, where the consumer pulled back on spending. Real estate prices went down. Consumers increased savings and paid down their debt. In this bubble recession or the bubble created during the recession as a result of credit, consumers are taking bigger mortgages. They are taking out more equity loans, which continue to this day. We almost have a bubble of mortgages and the bond market in consumption.



DR. FABER: I think you are raising a very important point. I think you are also very mild in your comments about the bubble in real estate. I don't think we have a bubble in real estate, but we certainly have a bubble in borrowing to purchase real estate. The mortgage credit growth in the third quarter was over \$900 billion annualized. In other words, 10% of GDP was to finance home purchases and to re-finance existing homes. That was close to 80% of total credit growth in the United States. In other words, you have a very strange credit distribution. The corporate sector did not borrow, but it was all borrowing mortgages in order to re-finance homes and purchase new homes. That is a very unhealthy situation. I think that eventually the residential market will also weaken quite substantially the way the commercial market has weakened. In some regions of the United States, office vacancies are around 20%. The vacancy rate of industrial properties is over 10%. I think that the real estate market had the bubble in commercial properties in the period of 1985-1986 and then the bubble burst and lead to the S&L crisis. And now we have a bubble developing in residential real estate – certainly in some areas in the United States, where prices have moved up far more than say personal disposable income.

JIM PUPLAVA: Let's talk about investment themes, which so much of your new book; *Tomorrow's Gold* is about. You write that the problem with major investment themes is that they are not widely recognized until they are well along the way. I think of the stock market bubble in the late 1990s. The average investor did not come into the stock market until 1995 and the final stages of a bull market. As you point out in the book, by the time the investment community is fascinated with a particular investment theme, in this case from 1995 on, stocks, it is best to look elsewhere.

DR. FABER: I think that is a very interesting point also. I think if you have an investment mania, such as gold in 1978-1980, Japanese stocks in 1988-1990 or the US stock market in 1998-2000, what you get is everyone is fascinated with that sector that goes up vertically. When in fact, the sector that goes vertically attracts so much money that there is a shortage of money in other sectors of the market, in other countries, which makes other investment opportunities very undervalued because they are neglected. If all the money of the world flows into high-tech, then obviously there is an undervaluation of commodities or real estate or in countries that do not participate in the high tech sector.

If I look around the world in the late 1990s and up to 2000, we had this terrific overvaluation of technology and telecommunication shares, and we had an incredible undervaluation of commodity prices, because commodity prices had been in the bear market essentially since the 1980s or since 1973 or 1977, depending on the commodity we are talking about. So the overvaluation of one sector in the economy, when there is a mania, creates undervaluation somewhere else. Therefore people, instead of focusing on the bubble and participating in the bubble, should look at the sectors that are undervalued during the bubble. This is something that Warren Buffett did in a way. He didn't participate in the high tech boom, but realized that as a result of the high tech boom, there were some stocks that were relatively undervalued elsewhere.

JIM PUPLAVA: The greatest opportunity, continuing along this theme, is when there is no obvious theme apparently at the moment that has taken hold of investor's mind. That is precisely when the next investment theme arrives on the scene.

DR. FABER: I think it is very important to understand that once a bubble bursts there are tremendous cross currents, because the majority of people don't believe that the bubble has burst. They think it is a correction in the bull market. They continue to chase the old sectors. In other words, if you look at Japan after 1989, the Nikkei touched 39,000. It then dropped to around 25,000 and then faded for about ten years between 18,000 and 27,000. And after ten years from 2000 onward to recently, dropped from 20,000 to 8,000. You also can have a trading range that thinks that every rally is the beginning of a new bull market. When in fact, the opportunity was no longer in Japan but in NASDAQ stocks and in the US stock market.



What I find interesting at the present time in the US is that first of all most people didn't sell their high tech stocks. They are holding on to them. They are hoping they will recover. There will be a rebound and maybe some tech stocks will go up 50-100%, but thereafter, they can still go bankrupt. If you look at the major technology companies of 1970—Memorex, University Computing, Wang—how many are still alive? Most of them went out of business. I think we can have rebounds in high tech, but what usually happens after a bubble bursts is that there is usually a change in leadership.

When the 1929 boom came to an end, the next leadership was not radio stocks, electric utility, movie companies, but new companies came into the market. Once the 1979-1980 oil and energy stock bubble burst, the next leadership

was other stocks, financial stocks, Japanese stocks. Once the Japanese bubble burst, it wasn't Japan that came back, but the US.

I think that people have to really focus on what is the next emerging trend. This period we are in is a period of tremendous drop currents, not just because the bubble burst, but because we have this new world, economic geography coming up as a result of the entry of China, India and the former Soviet Union into the world's economy. 3.6 billion people are joining the global economy, the market economy, the capitalistic system. These people will produce and consume goods. So, there is this tremendous wear and tear between pulling and pushing between deflation and inflation.

JIM PUPLAVA: You are talking about these new emerging trends. There is also still ingrained in the minds of most investors and analysts in the west, a paradigm that we have seen over the last two decades—one of low inflation, declining interest rates, a strong dollar, and a rising bond market. In my opinion and as you have written in your book, these trends are about to be reversed and along with it, the decline in US dominance.

DR. FABER: I think that to some extent, the US was extremely fortunate in the 1990s in terms of having very good public relations. I don't believe that US economic growth was that much stronger than say in Western European countries, but their statistics are compiled in a different way. Having said that, they were also fortunate in the sense that we have in the world, a number of problems. The world in the 1990s, unlike in the 1980s, was lacking synchronized growth. From 1990 onward to 1995, Europe didn't grow much. When it started to grow, we had the Mexican crisis in 1994 and then we had the bailout of Mexico through easy money. We had the IMF, which then created a new set of problems, which lead to the Asian crisis in 1997. Each time you try to solve a problem with easy money and bailouts; you create unintended consequences that create problems somewhere you don't expect them. Had Mexico not been bailed out in 1994, we would have had an Asian problem in 1994, but not a crisis.

As a result of the bailout, investors felt very comfortable, so they continued to lend and invest money into Asia and that lead to tremendous successes to the real estate market in Asia and the financial market when foreigners lost confidence. It lead to the crisis in 1997 where subsequently stock markets lost somewhere between 70-90% in dollar-terms. We have throughout the 1990s a lack of synchronized growth and a number of crises—Mexico, Asia, Russia, Argentina, and Brazil. And this always leads to foreigners accumulating US dollar reserves as a result of the American trade and current account deficits, but at the same time for security reasons and were optimistic about the US and continued to invest in the US in bonds and equity. I believe, in future, the appetite by foreigners to invest in US financial assets will not be as strong as it has been in the past. People may still buy US financial assets, stocks, bonds and make direct investments, but not to the tune of \$500 billion annually. When this happens, there will be other asset classes around the world that will perform better than US financial assets.

JIM PUPLAVA: Let's talk about two of the emerging investment themes in your book, *Tomorrow's Gold*. You talk about two of these themes as rising commodity prices and emerging economies, especially Asia. Address those two for a moment.

DR. FABER: I think that many investors misunderstand the situation in Asia. They look at the US GDP and it is essentially \$1.5 trillion. The Chinese GDP is \$1.2 trillion. So they say the US economy is larger than China. In money terms, this is probably correct. In unit terms, in many markets, this is not correct. You take for instance China. There are more motorcycles, refrigerators, radios, televisions, cellular phones in China than in the US. China produces more steel than the US and Japan combined and still imports steel. If you add to that the Indian market, which has also a billion people—in other words 1,000 million people—these two markets become extremely large in terms of physical output and physical consumption. In dollar terms, they are smaller because these countries have a much lower price level than the United States.

In Asia, we have 3.6 billion people. Starting in the west from Pakistan, extending to the east to Far East Russia, in the North from Mongolia, Pakistan extending to the south to New Zealand, this represents the largest physical

market in the world. If these peoples' standard of living increases, they will require more oil, more food and more industrial commodities.



I believe, given the low level commodities reached in the period of October 2001 through February 2002, that commodity prices which have been strong over the last 12 months—the CRB is up more than 25%—that this is the beginning of a bull market in commodities. Of course there will be setbacks. The price of gold the other day was at over \$380 and now it is below \$350. That is normal at the beginning of a major bull market that we have these kinds of setbacks. I think that over the next ten years, you will see significantly higher commodity prices.

I'll give you an example. In Switzerland the per capita consumption of coffee is 50 times higher than in China. But figure the Chinese population is 200 times larger than in Switzerland, the total imports of coffee into China are more important than the import of coffee into Switzerland for consumption. I think that the people in China will not go to the per capita consumption level of Switzerland, but they can go to the capital consumption level of South Korea or Japan, which is ten times higher than in China. Over the next five to ten years, the demand for commodities out of China can grow very dramatically and push up prices.

JIM PUPLAVA: Let's talk about a scenario I see developing, which I think is a very important concept for many to understand. How you can have existing at the same time, deflation throughout much of the economy and yet, rising commodity prices? There seems to be many schools of thought that you are either going to have inflation or deflation. With the implosion of credit and the contraction of credit that eventually comes from a bust, you can in fact have deflation, but at the same time, commodity inflation. Can you explain how both of those can exist at the same time?

DR. FABER: First of all, I would like to point out as I explained in the case of compiling statistics, the concept of inflation or deflation is very difficult to understand for some people. You can have deflation; the way the US had deflation in 1929-1932, when the price level fell by 30%. You can have the Japanese deflation as we had from 1990-2003 where the price level also declined, where the property prices dropped by 70% and so forth. Another type of deflation is the Latin American deflation of the 1980s. You have a domestic hyperinflation, meaning domestically the level of all goods increased, sometimes in Argentina, sometimes 800% in one year. But because the currency collapsed, you adjusted for strong currencies such as the dollar at the time and you had deflation. The currency depreciation exceeded the domestic price inflation and so you have your deflation through the foreign exchange market.

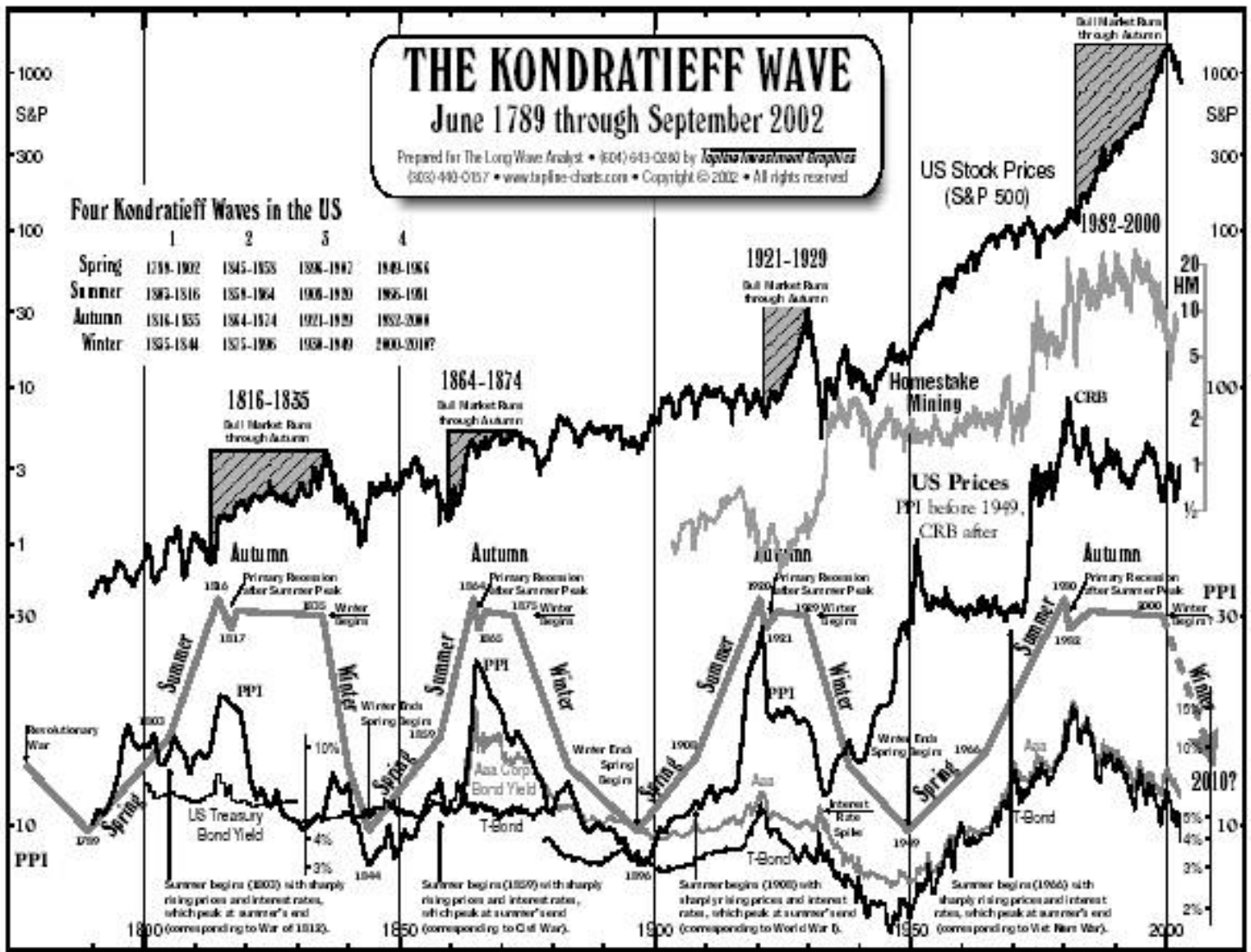
I would like to point out for the European, the US price level last year declined by 16%, because the Euro appreciated against the US dollar by 16%. In other words, if I am a European and went to the US 14 months ago, I paid 16% more than I am paying today because the price level in the US was essentially flat, but the dollar declined by 16%. In addition to that, the concept of inflation and deflation is difficult to understand because, say between 1980 and 2000; you had inflation in financial assets, in bonds and stocks, where there is inflation in financial assets. We call it a bull market, but it is essentially the same like an inflation in commodity prices or an inflation of the Consumer Price Index. During the same period 1980-2000, we have deflation of all commodity prices. They all declined dramatically and adjustments for the Consumer Price Index were extremely low by the year 2002. The way you could have inflation in financial assets and deflation in commodities, you could have in the next ten years inflation in commodity prices and deflation in financial assets. In particular, I think the bond market in the US is becoming price vulnerable.

JIM PUPLAVA: Let's move on and talk about your study of cycles. I think they are important in understanding how markets evolve. You have quite a bit of time devoted in your book, *Tomorrow's Gold*, and also the Kondratieff Wave. Can you address some of those issues?

DR. FABER: It is not a subject I can discuss in one minute, but basically what happens is you have a trend line growth in the world's economy of say 3 or 4% per annum. Occasionally, because of some unusual conditions, inventions or discoveries, you can go into a so call excursion of prosperity. Then the growth rate will go above the average and maybe reach 5 or 6% for a period of time. Then you build excess capacities and you get into booms such as we had in the late 1990s. What usually follows is a bust and then you go into an excursion of depression or recession and the excesses are corrected. The business cycles do exist. Some economists claim that they occur, according to Juglar, every eight to twelve years. But according to Kondratieff and Schumpeter, you have these long waves that occur. You have a rising wave of about 15 to 25 years, then there is a plateau and downward again for 15 to 25 years. And then you have a drop and the entire cycle starts again. You have all kinds of cycle theory. I am not so sure you can measure the timing of the peak and the bottom, but definitely cycles do exist. There are times when an economy will perform better for some reasons and other times when it performs less well for other reasons. People have to realize this is a very normal type of process in the capitalistic economic development.

JIM PUPLAVA: Explain if you would, where you think we are in a broader sense along this cycle—even looking at it from a Kondratieff Wave perspective. Are we in a downward cycle or are we about to emerge and move into an upward cycle?

DR. FABER: Well, I have to explain Nickolai Kondratieff wrote his books in the 1920s. It wasn't meant to be a business cycle theory. But he observed that in the last 100 years, between 1780 and 1920, there have been distinctive price cycles – a rising price cycle between 1780-1816, then a downward cycle until about 1840, rising to 1864, falling around 1900, rising 1921. Then he forecasted it would decline into the 1940s. According to the cycle theory, the Kondratieff price cycle peaked out between 1973 and 1980 and has been since then into a downward wave. The Kondratieff cycle is purely a price cycle and he wrote in his book that he doesn't claim to have an explanation as to why this happens. It was then expanded by Joseph Schumpeter into a business cycle theory, with which he tried to explain why there are these up and down cycles and he essentially formed a theory around the cycle of innovations.



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According to both theories, we are in a down cycle that is about to **bottom out between today and 2006**. And thereafter, you have a rising price cycle. What is missing for the cycle to have bottom out, near the bottom of the cycle, you have massive liquidation of debts. This has not happened and that is the problem for the global economy. **The debt deflation or the reduction of debt will have to occur, either through massive defaults or it will have to occur through hyperinflation.** In hyperinflation times, nominal debts also become worthless.

JIM PUPLAVA: In looking at what we are doing today, the way Central Banks are responding, especially the Central Bank in the US, what is your perspective? Where do you think we are heading? We are still expanding our money supply. Credit creation is growing at an unhealthy rate in the US and none of the liquidation and mal-investments of the last boom have been liquidated. This does present a problem that hangs over the US economy and financial markets. They seem to want to prop it up. You and I know in the end at some point that can't happen.



DR. FABER: Yes, again this is a very complicated issue. In my opinion, the issue is there is a chance that

the economic theory will have to be re-written. Traditionally, when you print money, there will be inflation. In general, I subscribe to this theory. On the other hand, I give you a scenario where this will not necessarily take place. Let's say, you print a massive amount of money in the United States and borrowing has increased. As a result, retail sales and the housing market strengthen.

Take the housing market. We have boom conditions in the US housing market, although a recent performance would suggest that the housing market will go down significantly, because housing stocks have not confirmed the strong housing conditions. They peaked out half a year ago. Just in the last week, KB Homes and others have declined. Now although you have booming housing conditions in the US, if you look at industrial production of appliances is flat, but the import of appliances have soared. If you look at the home furnishing industry in the United States, it is flat to down, the unemployment rate in home furniture is rising, but the import of home furniture from China is up over 70% in the last three years. So, you spend in the US, but you produce elsewhere. Now, the more easy money you have, the more borrowings you have, the more capacity is being expanded in China, which in turn produces goods at lower costs and export deflation.

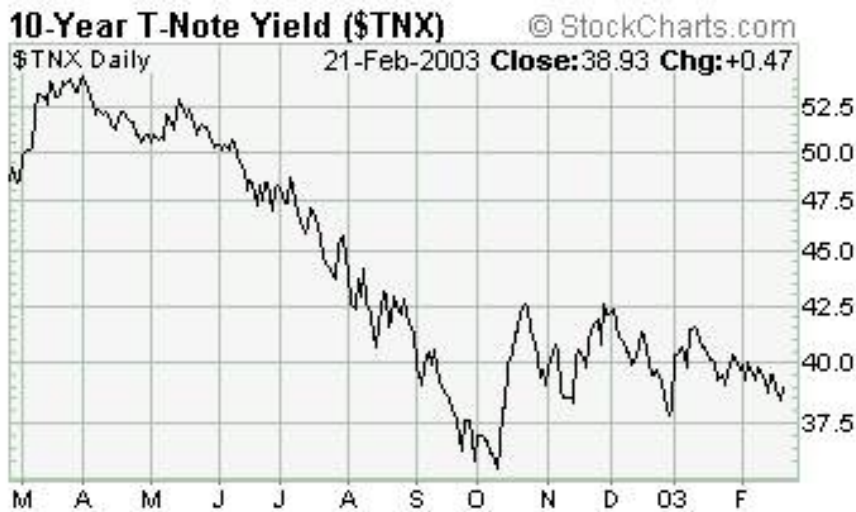


I wonder how these imbalances will be solved. What is possible is the dollar will collapse. But the only problem I see is, collapse against what? We have a dollar that is sick as a result of the internal imbalances, the trade and current account deficits. We have a Euro that is not a particularly encouraging currency, although I am more positive about Euroland than most people are, because I think the inclusion of other Eastern European countries will be positive. We have a yen that is also sick currency. So you tell me where to go. We have three major paper currencies, the Dollar, the Euro and the

Yen. And then you have hard currency, which is gold, and a basket of commodities. I think the depreciation of the dollar will be against the basket of commodities. If there is one strong paper currency, it is probably the Chinese Renminbi at the present time.

As I said, if you ask me in three years time, do we have inflation rates between 7% and 10% or do we have deflation in the US? I would lean to say we will have more inflation, based on the comments by Mr. Greenspan and especially on the comments from Mr. Bernanke. If you read the comments of Mr. Bernanke, who is intended to be the next Fed Chairman, you should sell every financial asset in the United States and move into hard assets or foreign currency. He is an extremely dangerous man.

JIM PUPLAVA: Is it possible that we see all currencies depreciate against a basket of commodities?



DR. FABER: This is entirely possible. If I look around the world, I see financial assets that are expensive, like bonds in some countries. For instance in the US, a 10-Year Treasury yields less than 4%. Real estate is relatively expensive in the US, but I think that people having lost so much in financial assets. They say, "Why would I buy shares? I don't know the management. They are all crooks." This is very true. Most of them are not particularly honest. They always lie. The government is not particularly honest either on the statistics they publish that no one can trust.

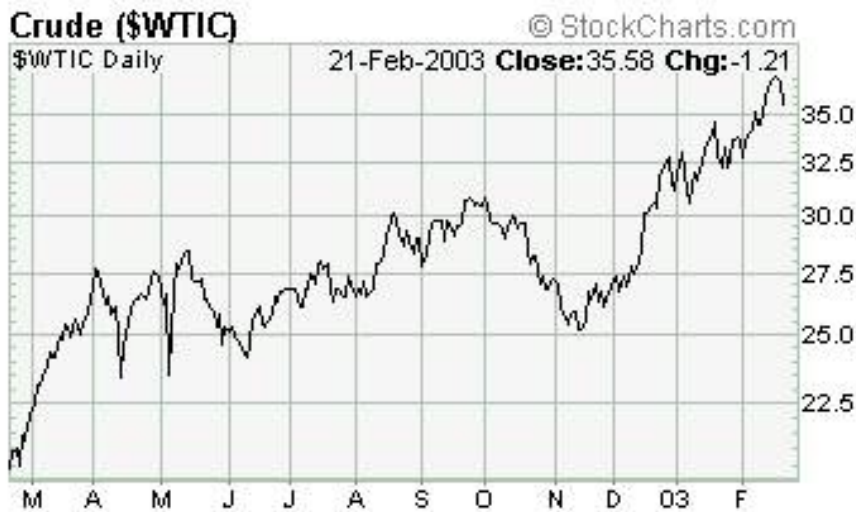
So, you live in a small village and you have 200 houses in the village. So you don't have to be a real estate expert to have some kind of feel for the market in the local village. So I understand that people started to buy homes three years ago. I see in Asia, if people have some money, the first priority is not to have a stock portfolio, the first priority is to own a home. In emerging economies, real estate is essentially very inexpensive. I think I would rather, as an investor, consider some hard assets and commodities, rather than financial assets at the present time. The reason I am stressing the commodity play so much is that usually emerging economies, have a very close correlation in commodity prices. In other words, if you have rising commodity prices for grain, metals and so forth, countries like Argentina, Brazil, Russia, Indonesia, Malaysia, to some extent, Thailand and the Philippines, they will perform relatively well. This, given the fact that their markets collapsed in 1997 and 2000, and that since then they will build bases from inexpensive price levels, you may get very strong upward moves.

JIM PUPLAVA: Let's talk about some of the importance and some of the dangers of financial markets to global economies. This is something that emerged in the last two decades that perhaps did not exist prior to 1980. In other words, the financial markets were not as interlinked or tied and essential to economic activity in the way that they are today. I wonder if you might comment on that?

DR. FABER: I think, again, this is a very important point to consider if we compare the economy of the 1950s and 1960s and today. Normally, if you analyze economic activity, you look at *real* economic activity in a country and based on your analysis of industrial production, retail sales, housing activity, consumer confidence, you will say, the stock market will do such and such. But, over the last 25 years, the financial markets have grown disproportionately large compared to the *real* economy. In other words, the Debt to GDP Ratio is over 300%. Meaning for \$1 of economic growth, we have \$3 of outstanding debt and that is growing rapidly. The stock market capitalization as a percentage of the economy is still over 100%.

Today's economist doesn't have to look at the *real* economic activity, but he looks at the financial market and says, "If the financial market goes up 50%, the stock market recovers from 800 on the S&P to say 1200 or 1300, then the economy will be strong. And if the stock market goes down further, it will be weak." I think this is a very dangerous situation, when you have the financial market being this large, because it leads the Fed to understand that it has to boost the share market quickly, at any costs, to whatever it takes to push up stock prices. As I mentioned, the Central Bank only controls the *quantity* of money it can push into the world, it cannot control *where* the money will flow. It doesn't have to necessarily flow into equities. It can flow into real estate and it can one day flow into inflation and into a weaker dollar.

JIM PUPLAVA: Well this is certainly something we are starting to see. As you and I are talking, the CRB Index in the US is up to \$248. Oil prices are close to \$35 a barrel. We are certainly seeing money move into *things*. I want to move on to your discussion on Asia.



DR. FABER: May, I just add one point? What is interesting in the US, people say that oil prices are up because of the impending Iraqi crisis and the stock market is weak because of the war. I am not sure this way of reasoning is correct. Maybe there will be an Iraqi war, because oil prices went up. The economy is sluggish and the stock market is down. Who knows what the cause is and what is the effect? I am quite cynical about this. The war attitude of the US has something to do with the economic weakness at the present time and with oil prices having risen so much.

JIM PUPLAVA: I would agree with you. In fact, here in the US, the financial media continues to proclaim the rise in gold has more to do with the Iraqi war, which I don't buy looking at the fundamentals and the move to hard assets. Would you agree with that assumption?

DR. FABER: Yes, I think that is probably some argument to be made that some people voted because they thought the Iraqi war would push it up. I would rather think that some smart money looked at the currency markets, saw the dollar weakening, and didn't like the Euro or the Yen. So they shifted money into hard currency—which cannot be manipulated by the Central Bank—which is gold. If you look at the comparison of gold prices in the DOW Jones over the last 50 years, obviously gold is relatively inexpensive as compared to equities.

5- Yr. Gold vs. Dow Industrials

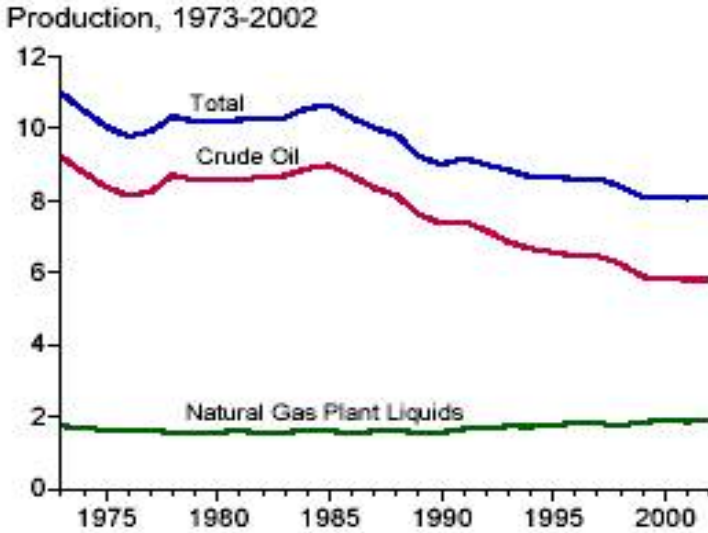


JIM PUPLAVA: Let me come back to Asia. You devote part of your book to it. Let's talk about why Asia is important and the role of an emerging China. Then once again, tie that as you have spoken recently, into commodities.

DR. FABER: I think, if you look at China and compare it to the economic development to South Korea between 1965 and 1980 or Japan between 1950 and 1975, you will find that in the case of the economic development of Japan and South Korea, the per capita consumption of all commodities increased very rapidly as economic development progressed and as standard of living increased. In the case of Japan and South Korea, the per capita consumption of oil, went from roughly one barrel to around 17 barrels per annum in the phase of economic development, which lasted around 30 years. In the case of China today, the per capita consumption of oil is still around one barrel. This is compared to the United States, which has a per capita consumption of 22 barrels of oil. In the US you consume twenty times more oil per capita than China. Now I don't think in China you will go to that kind of consumption levels. I think you can go to the level of Latin America, which is around four barrels. And for the whole of Asia we have now a daily consumption of 19 million barrels, compared to the US consumption of 22 million barrels. The US consumption is ten times higher than the whole of Asia. If we go up to the level of Latin America, we would be consuming something like 35-45 million barrels a day. I think on an oil market, which is today, total production around 78 million barrels, would drive prices higher in the long run. I cannot judge what prices will do if

there is or isn't an Iraqi war. I am convinced that the oil price will go up very substantially.

Petroleum Overview



Natural Gas Overview

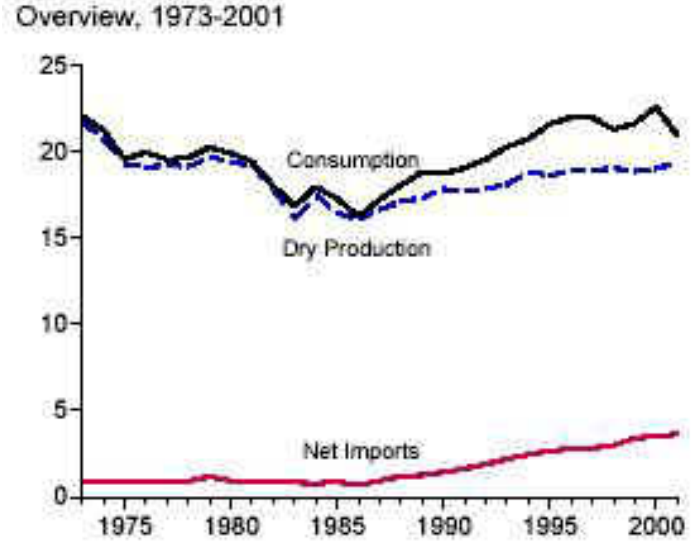
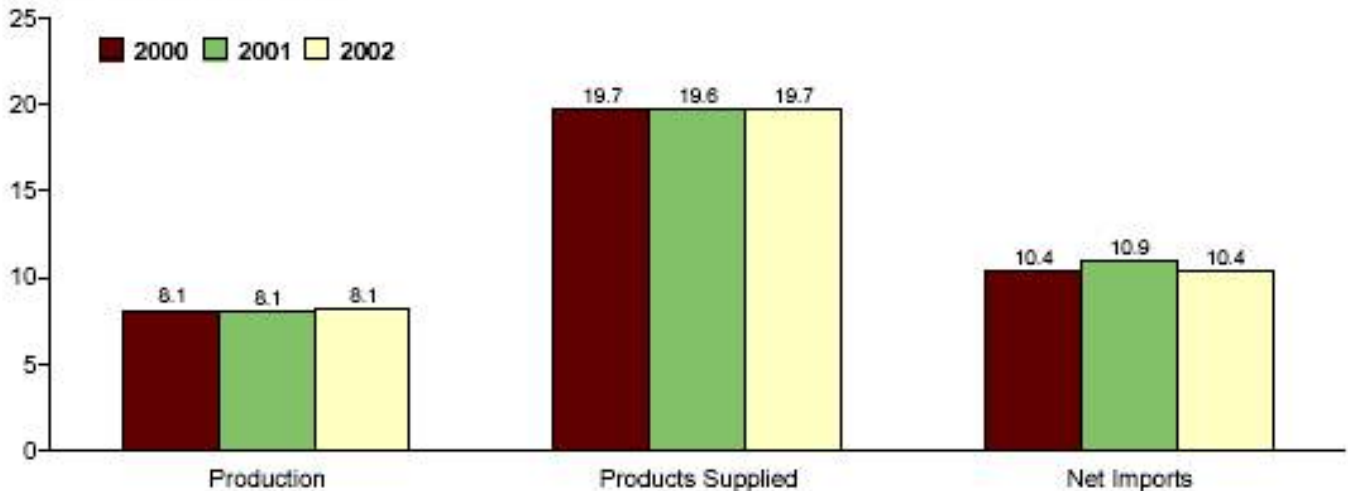


Figure 3.1a Petroleum Overview
(Million Barrels per Day)

Overview, January-December



www.eia.doe.gov

JIM PUPLAVA: I want to second that thought, because I am very bullish on energy. I look at Western oil production, which has gone into decline in the US since 1971. Even our large oil fields in Prudoe Bay have gone consistently in decline. You have in the North Sea oil production in decline. I want to talk about the importance of this, because one of the strengths in the development in the United States has been cheap energy and the implications that this may have. If China goes from an annual consumption of one barrel per capita to four, you are looking at OPEC's excess capacity being completely utilized and consumed by this extra demand coming in from Asia. I can't help but think that the only way this will be resolved is higher prices overall for a long time. Number two, what are the prospects of military confrontation over this exact issue?

DR. FABER: It is very interesting that you touch on it, because you spoke before in the Kondratieff Wave, you get an upturn in commodities. Usually you get a conflict because countries want to secure the reserve of resources and

therefore most wars have occurred in these so-called "up-waves." I agree with you, I think the problem is the US wants to get Saddam Hussein out. I think he is an evil person and deserves to be out, but the consequences may be quite unpleasant, because who knows who is going thereafter? The only point I am sure about is that nobody in the world will tolerate that the US will stay in the Middle East. Russia and China certainly don't want the US to control the oil fields. The whole Islamic world will not welcome a US presence in the Middle East. It can only end in a total disaster. In my opinion, to get Saddam out is not the problem. The problem will be the re-construction thereafter.

The problem will be Saudi Arabia because Saudi Arabia appears to me to be a country like France under Louis the 16th just a week before the revolution. It is a régime that cannot be sustained in the long run. Half the people in Saudi Arabia are under 20 years old and have no jobs. There are no industries. What do you want to produce in Saudi Arabia? Radios? TVs? Semi-conductors? Impossible. Agriculture? Impossible. There is only one industry. It is oil and petrol-related industries. But that doesn't require a lot of workers. The entire country is subsidized by the oil industry. When people tell me that the oil price will collapse, I tell them that if that happens, it will happen for a very brief amount of time, because an oil price collapse will ensure a revolution in Saudi Arabia because they will not have enough money to support the population. I think that the Middle Eastern problem goes very deep and that US intervention will not help much in the long run. It may get Saddam out, but what is going to be there afterwards?

JIM PUPLAVA: You talk about an emerging China in your book, a strength that is developing, its military power, and it is developing a blue-water Navy. What is the possibility in your mind over the next decade that this eventually will lead to a confrontation between the US and China?

DR. FABER: That I don't believe. I think the prime concern for China today is domestic economic growth and creating a society that is reasonably affluent. I don't think they have as yet major geopolitical ambitions, unless it is to secure access to resources. That you know China is increasingly dependent on Middle Eastern oil. They are building pipelines from Russia to China and from Kazakhstan to China, but still they will require a lot of oil from the Middle East. If oil flows through the [Straits of Malacca](#), which is essentially between Malaysia and the Island of Sumatra, one American aircraft carrier could block the access of oil to the Chinese. So they are concerned about this and they will want to have secure oil supplies. But other than that, I don't think they will be major troublemakers in the world yet. I am pointing out, yet. What may happen in the future, who knows?

It would seem to me that the friendship between Russia and China will not last a very long time because the Chinese may be interested in the Russian resources in Far East Russia, which was actually conquered by Russia in the 19th century and originally belonged to China. They may claim that territory at some point and I think that the Chinese will want more interest in South East Asia, which may displease the Americans in the long run. There may be some trade wars simply because the US is having larger and larger trade deficits with China. Of course the US has been a major investor in China, so I think they will not be a major conflict yet. But obviously at some stage in the future when Chinese and American views are totally opposite or differ from each other, you could have some conflict.

JIM PUPLAVA: I have a couple of final questions. In your book you talk about, and we discussed this earlier, how an investor could have made very few investment decisions over the last three or four decades by rising or staying with one particular trend. One trend was the rise of economic influence in the 1990s in the US market. But you talk about in the book, the rise and fall of centers of prosperity, and more importantly why the US is unlikely to provide leadership in the next up-turn.

DR. FABER: I think if you look at history, then obviously we had cities that became very rich and then became more or less impoverished. The first centers of prosperity were along the silk roads, and then the Mediterranean cities became important under the Phoenicians, then Rome, then Byzantine. Then in the early Middle Ages, we had the Italian trading cities of Venice and Florence. Then later on with the discoveries of the Americas and the route to Asia around the Cape of Good Hope, Lisbon, Antwerp Bruges, Amsterdam, and then finally London. After the Industrial Revolution, you see cities that rose, such as Manchester, Birmingham and then later the American cities. So there has been a constant change in the world's economic geography. It is nothing new. Cities became rich and then disintegrated or lost out to new competitors.

All I am suggesting is that before the great sound of the Communist and Socialist ideology and before the end of policies of self-reliance and isolation in India, we have essentially a relatively small capitalist market economy in the world. Big nations like the Soviet Union, India and China, who did not participate, were not competitors and were not clients of ours. Now, these countries come up, join the global economy and you will have new centers of prosperity coming up and displacing old ones.

Who spoke of India or the Dalmation Coast in Croatia years ago? Who spoke of Shanghai ten years ago? Yet some of these places have become really well to do or have been growing at more than 10 to 12% per annum in the last ten years. So new centers of prosperity have been created. If you look at the stock market, there are always new companies that come up. 30 years ago Microsoft didn't exist. Dell didn't exist. Cisco didn't exist. And others, old established companies, are out of business. In the same way, you will have new countries coming up, displacing old ones. It doesn't mean the old ones go out of business. Manchester still exists. Venice still exists. But they are no longer the vibrant economies they were in the past. I would not rule out that in ten years time the stock market capitalization will be higher than in the United States. In 1970 IBM alone had a bigger stock market capitalization than the entire Japanese stock market. 20 years later the Japanese stock market had a larger market value than the US, Great Britain and Germany combined.

JIM PUPLAVA: So things change over time.

DR. FABER: Yes, I think they change over time. But people must realize that today we are in a period where history is accelerating. 100 years ago, to send a message or parcels from A to B, took a long time. Today you have instant communication. Where I wasn't optimistic about Internet shares, I have to say that the Internet allows every person in the world, in the last little village, to essentially transfer the knowledge and experience of highly educated scientists, people involved in technology with any kind of knowledge, to their own. Today you can have people who suddenly invent things in remote villages. Before, people had to go search for books in libraries and couldn't afford them. And so they couldn't acquire the knowledge. Today with the Internet, the entire world can acquire knowledge very quickly. You can build new factories in China in no time and compete with existing people around the world. This, people have to realize, these changes will be mind boggling in the next five to ten years in the world. It will be unbelievable—changes that people cannot imagine. I saw Shanghai years ago and it was nothing at all in terms of economic development. In ten years it has become a modern city. In the next ten years, you will have 50 cities in the world become relatively modern and compete with old centers.

JIM PUPLAVA: Finally, if there was one thought or one main theme that you would want investors to learn or understand from your new book, *Tomorrow's Gold*, what would it be?

DR. FABER: We all make big mistakes in life and I think we all have to start from the premise that we don't know anything of what will happen in five minutes time, let alone in ten years' time. If you realize that you don't know, you should be very careful in how you invest your money and you should diversify. You should have US dollars and some Euros and some gold and bonds and equities and so forth. But I would say that the most important lesson is to know that you have no idea what will happen in the future and you certainly don't know more than other people, because there are other people who are more intelligent than you are.

So I think that in this environment and with this knowledge of uncertainty, you should treat very carefully your investments and diversify, not borrow money against your investments and not enter highly speculative positions. For instance for me, it is almost criminal that someone borrows 100% against his home. He doesn't know that his home price will be up 20% or down 12% in the next 12 months. He has no idea about it; he doesn't know what the interest rate will be in 12 months time. Maybe it will go down or maybe they will be up substantially. I would just say you have to be able to sleep well at night.

JIM PUPLAVA: On that note, why don't you tell our listeners and readers about your newsletter and your website? I receive your newsletter and I just want to compliment you that when I get it, I usually can't put it

down. I have to read it immediately.

DR. FABER: That is very kind of you. It is www.gloomboomdoom.com



JIM PUPLAVA: The name of the book is called *Tomorrow's Gold – Asia's Age of Discovery*. I want to thank you for joining us on Financial Sense Newshour. Your new book has tremendous insight and is very thought provoking. I would recommend our readers and listeners to our show to pick up a copy. I think it is key to understanding the decade ahead of us. As always you have been a perfect gentleman and scholar. I wish you all the best with your new book. Thank You.

DR. FABER: I am more modest about my knowledge.

JIM PUPLAVA: Thanks so much.

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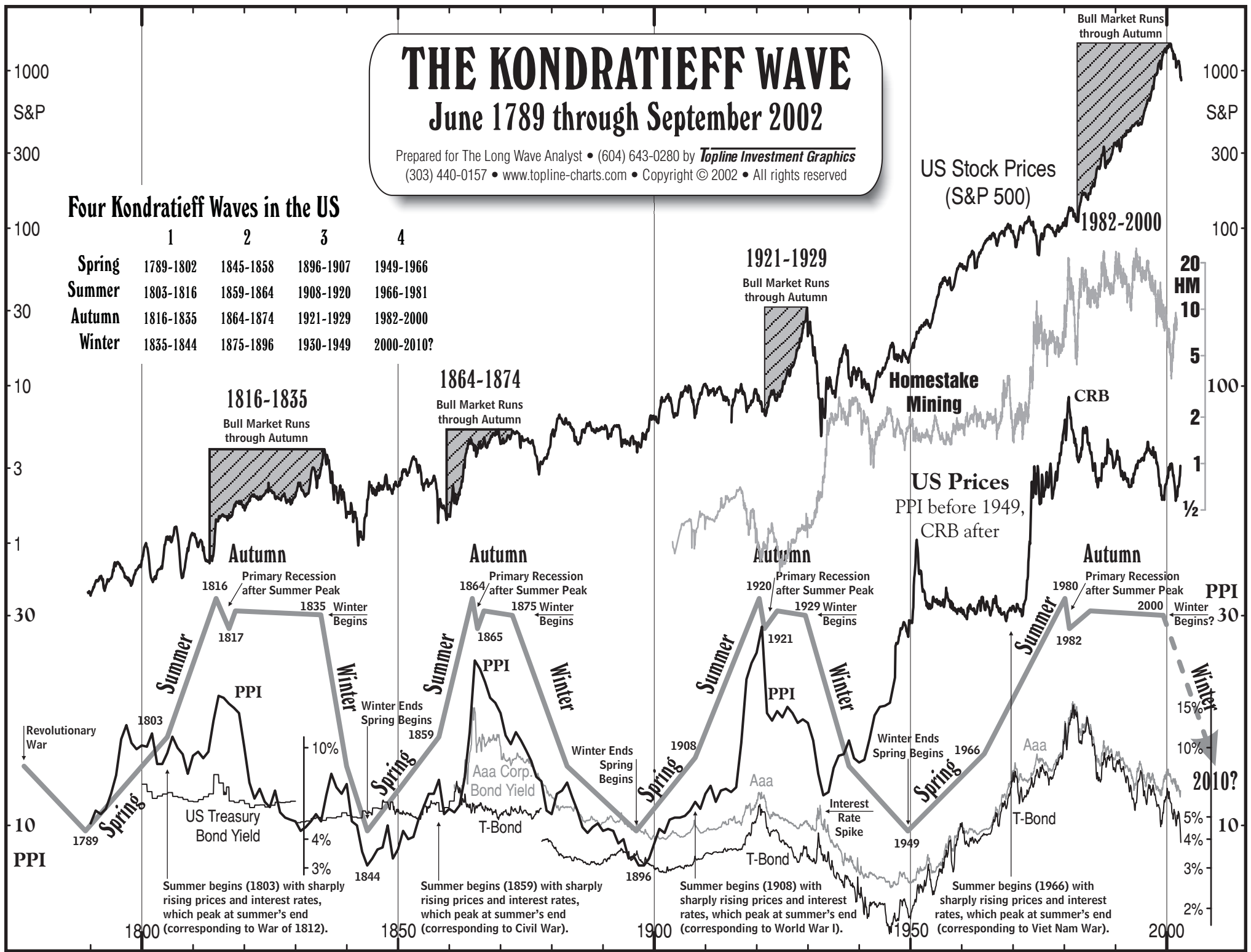
THE KONDRATIEFF WAVE

June 1789 through September 2002

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Four Kondratieff Waves in the US

	1	2	3	4
Spring	1789-1802	1845-1858	1896-1907	1949-1966
Summer	1803-1816	1859-1864	1908-1920	1966-1981
Autumn	1816-1835	1864-1874	1921-1929	1982-2000
Winter	1835-1844	1875-1896	1930-1949	2000-2010?



1816-1835

Bull Market Runs through Autumn

1864-1874

Bull Market Runs through Autumn

1921-1929

Bull Market Runs through Autumn

Bull Market Runs through Autumn

US Stock Prices (S&P 500)

1982-2000

Homestake Mining

CRB

US Prices
PPI before 1949,
CRB after

Autumn

Autumn

Autumn

Autumn

Primary Recession after Summer Peak

Primary Recession after Summer Peak

Primary Recession after Summer Peak

Primary Recession after Summer Peak

1816

1817

1835

1844

1864

1865

1875

1896

1920

1921

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1949

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