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THE "YOU MAY NOT KNOW REPORT"

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Could This Be The Beginning of the End of the Petro-Dollar?

By Dennis Tubbergen

As the April issue of the "You May Not Know Report" is being written and assembled, "The Wall Street Journal" published a story reporting on a situation that potentially has major implications for the US Dollar and the current inflationary environment.

It should be noted that this report is written approximately 3 weeks before it hits mailboxes. As you all are aware, a lot can change in 3 weeks particularly at the present.

The story[1] to which I am referring was published on March 15 and reported that Saudi Arabia is now seriously talking with China about pricing oil exports in the Chinese currency rather than in US Dollars as has been the case since the 1970's. It's important to note that at the time this issue

of the "You May Not Know Report" is going to print, this is a PROPOSED change, still in the discussion stage, no changes have actually taken place.

On the surface, to many readers, this may not seem like a big issue. But, the reality is it has huge implications for the US Dollar and those who use it.

To properly understand these possible implications, some context is important.

Going all the way back in time to 1944, there was a worldwide monetary agreement that is now known as "The Bretton Woods Agreement". It was that agreement that made the US Dollar the world's reserve currency. Because of the assurances that the United States made to the rest of the world in this agreement, the US Dollar became the currency that the rest of the world was comfortable using in international trade.

The crux of the Bretton Woods Agreement was that the United States would back its dollars with gold. Any foreign entity that possessed US Dollars could exchange those dollars for gold at the exchange rate of $35 US Dollars to one ounce of gold.

At the time the Bretton Woods agreement was implemented, the United States had more than 20,000 tons of gold[2]. This gold essentially collateralized the promise that the US Government made to the rest of the world.

Over time, as they always do, the Washington politicians overspent and overpromised. By the 1960's there was another expensive war raging in Viet Nam and congress and President Johnson birthed the Medicare and Medicaid programs. There was not enough tax revenue to cover all these expenditures, so the currency creation began.

The rest of the world got nervous. They began to exchange their US Dollars for gold as they were entitled to do under the Bretton Woods agreement.

In 1965, the French President, Charles De Gaulle, warned of an inevitable monetary crisis due to the profligate spending of the US Government. Here is an excerpt[3] from a speech by Mr. De Gaulle from that year (if you want to watch the speech, follow the link in the "Sources" section below):

> *"The fact that many countries accept as a principle, dollars as good as gold for the payment of the differences existing to their advantage in the American balance of trade, this very fact, leads Americans, to get into debt and to get into debt for free at the expense of other countries. Because, what the US owes them, it is paid, at least in part, with dollars they are the only ones allowed to emit.*
>
> *Considering the serious consequences a crisis would have in such a domain, we think that measures must be taken on time to avoid it. We consider necessary that international trade be established, as it was the case, before the great misfortunes of the World, on an indisputable monetary base, and one that does not bear the mark of any particular country. Which base? In truth, no one sees how one could really have any standard criterion other than GOLD. "*

Mr. De Gaulle correctly stated under the Bretton Woods system, the US could 'get into debt

for free at the expense of other countries'.

By 1971, after countries continued to exchange their US Dollars for gold, the gold reserves of the United States dwindled to 8000 tons[4]. The chart (below) illustrates.

As an interesting, but extremely important side note, the gold reserves of the United States were last audited in 1953[5].

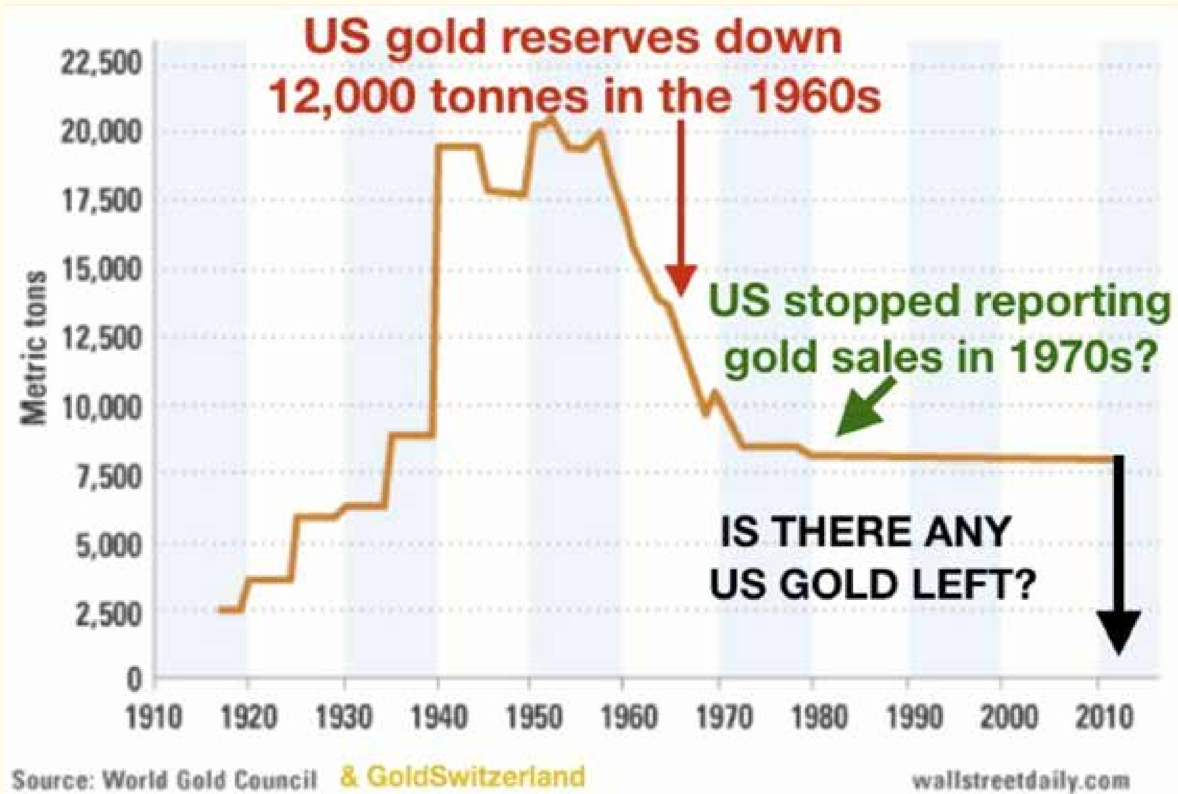
As many readers know, in 1971, Richard Nixon made a televised speech in which he announced the United States was 'temporarily' suspending the ability to convert US Dollar to gold. This, according to Nixon, was to protect the US Dollar from 'international currency speculators'.

Of course, these international currency speculators didn't exist but given the run on the bank that was taking place with countries demanding gold for their US Dollars, Nixon had two choices. It was either renege on the Bretton Woods agreement or get the United States' financial house in order and operate with a balanced budget.

Predictably, Nixon chose the former.

Now, however, there was no reason for foreign governments to inventory US Dollars. That created a huge problem for the free spending group of politicians that resided in Washington at the time. What was needed was a system to keep demand for US Dollars high even though the United States could no longer back the currency with gold.

By 1974, a new system was in place. It established the Petro-dollar. An excellent piece[6] written by Jerry Robinson, director of economic research at FTM Daily explains. Here are some excerpts:



In the early 1970s, the final vestiges of the international gold-backed dollar standard, known as the Bretton Woods arrangement, had collapsed. Many foreign nations, who had previously agreed to a gold-backed dollar as the global reserve currency, were now having serious mixed feelings toward the arrangement. Nations like Britain, France, and Germany determined that a cash-strapped and debt-crazed United States was in no financial shape to be leading the global economy. They were just a few of the many nations who began demanding gold in exchange for their dollars.

Despite pressure from foreign nations to protect the dollar's value by reining in excessive government spending, Washington displayed little fiscal constraint and continued to live far beyond its means. It had become obvious to all that America lacked the basic fiscal discipline which could prevent a destruction of its own currency.

Like previous governments before it, America had figured out how to "game" the global reserve currency system for its own benefit, leaving foreign nations in an economically vulnerable position. After America, and its citizens, had tasted the sweet fruit of excessive living at the expense of other nations, the party was over.

It is unfair, however, to say that the Washington elites were blind to the deep economic issues confronting it in the late 1960's and early 1970's. **Washington knew that the "dollars for gold" had become completely unsustainable. But instead of seeking solutions to the global economic imbalances that had been created by America's excessive deficits, Washington's primary concern was how to gain an even greater stranglehold on the global economy.**

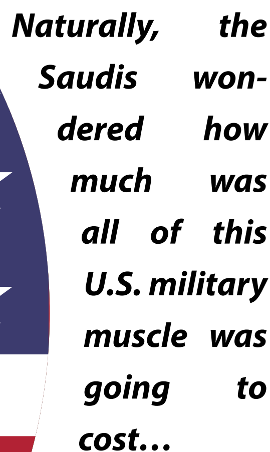
After America, and its citizens, had tasted the sweet fruit of excessive living at the expense of other nations, there was no turning back.

In order to ensure their economic hegemony, and thereby preserve an increasing demand for the dollar, the Washington elites needed a plan. In order for this plan to succeed, it would require that the artificial dollar demand that had been lost in the wake of the Bretton Woods collapse be replaced through some other mechanism.

In a series of meetings, the United States — represented by then U.S. Secretary of State Henry Kissinger — and the Saudi royal family made a powerful agreement. (Several authors have worked to compile data on the origins of the petrodollar system, some exhaustively, including: Richard Duncan, William R. Clark, David E. Spiro, Charles Goyette and F. William Engdahl).

According to the agreement, the United States would offer military protection for Saudi Arabia's oil fields. ***The U.S. also agreed to provide the Saudis with weapons, and perhaps most importantly, guaranteed protection from Israel.***

The Saudi royal family knew a good deal when they saw one. They were more than happy to accept American weapons and a U.S. guarantee to restrain attacks from neighboring Israel.



Naturally, the Saudis wondered how much was all of this U.S. military muscle was going to cost…

What exactly did the United States want in exchange for their weapons and military protection?

The Americans laid out their terms. They were simple, and two-fold.

1. *The Saudis must agree to price* ***all*** *of their oil sales in* ***U.S. dollars only****. (In other words, the Saudis were to refuse all other currencies, except the U.S. dollar, as payment for their oil exports.)*
2. *The Saudis would be open to investing their surplus oil proceeds in* ***U.S. debt securities****.*

You can almost hear one of the Saudi officials in a meeting saying: ***"Really? That's all? You don't want any of our money or our oil? You just want to tell us how to price our oil and then you will give us weapons, military support, and guaranteed protection from our enemy, Israel? You've got a deal!"***

However, the U.S. had done its economic homework. If they could get the Saudis to buy into this deal, it would be enough to launch them into the economic stratosphere in the coming decades.

Fast forward to 1974 and the petrodollar system was fully operational in Saudi Arabia.

And just as the United States had cleverly calculated, it did not take long before other oil-producing nations wanted in*.*

By 1975, ***all*** *of the oil-producing nations of OPEC had agreed to price their oil in dollars and to hold their surplus oil proceeds in U.S. government debt securities in exchange for the generous offers by the U.S.*

So, for about the last 50 years, the US Dollar has been required for payment for any country looking to buy oil from Saudi Arabia.

Now, that may be about to change. Now that you have that context, let's go back and discuss the article from "The Wall Street Journal" that I referenced at the outset of this article. (The link to the article is in the "Sources" section below.) The headline on the article reads "Saudi Arabia Considers Accepting Yuan instead of Dollars for Chinese Oil Sales". Here are some excerpts:

Saudi Arabia is in active talks with Beijing to price some of its oil sales to China in yuan, people familiar with the matter said, a move that would dent the U.S. dollar's dominance of the global petroleum market and mark another shift by the world's top crude exporter toward Asia.

The talks with China over yuan-priced oil contracts have been off and on for six years but have accelerated this year as the Saudis have grown increasingly unhappy with decades-old U.S. security commitments to defend the kingdom, the people said.

The Saudis are angry over the U.S.'s lack of support for their intervention in the Yemen civil war, and over the Biden administration's attempt to strike a deal with Iran over its nuclear program. Saudi officials have said they were shocked by the precipitous U.S. withdrawal from Afghanistan last year.

China buys more than 25% of the oil that Saudi Arabia exports. If priced in yuan, those sales would boost the standing of China's currency. The Saudis are also considering including yuan-denominated futures contracts, known as the petroyuan, in the pricing model of Saudi Arabian Oil Co. , known as Aramco.

It would be a profound shift for Saudi Arabia to price even some of its roughly 6.2 million barrels of day of crude exports in anything other than dollars. The majority of global oil sales—around 80%—are done in dollars, and the Saudis have traded oil exclusively in dollars since 1974, in a deal with the Nixon administration that included security guarantees for the kingdom.

China introduced yuan-priced oil contracts in 2018 as part of its efforts to make its currency tradable across the world, but they haven't made a dent in the dollar's dominance of the oil market. For China, using dollars has become a hazard highlighted by U.S. sanctions on Iran over its nuclear program and on Russia in response to the Ukraine invasion.

China has stepped up its courtship of the Saudi kingdom. In recent years, China has helped Saudi Arabia build its own ballistic missiles, consulted on a nuclear program and begun investing in Crown Prince Mohammed bin Salman's pet projects, such as Neom, a futuristic new city. Saudi Arabia has invited Chinese President Xi Jinping to visit later this year.

In 1971, when the link between the US Dollar and gold was eliminated, the US was at a crossroad, get your financial house in order or invent another monetary system that would allow the US Dollars dominance to continue and allow the US Government to 'get into debt for free at the expense of other countries' to once again quote Charles De Gaulle.

While the shift away from the petro-dollar has not officially occurred, it is only a matter of time. The shift is inevitable in my view.

When this shift occurs, there will be no option left to allow the 'getting into debt for free' party to continue. This will likely mean an even weaker US Dollar and more inflation fuel.

Mortgage Rates Surge Higher

I have previously offered my opinion that we now find ourselves near the peak of an “everything bubble”. While picking tops and bottoms in any market is a fool’s game, the real estate market is now facing some strong headwinds in the form of higher mortgage rates (a trend I discussed last month that continues this month).

This[7] from “Mortgage News Daily”:

> *When investors sell bonds, yields/rates move higher. That began happening early today and it continued to happen throughout the trading session. Ongoing momentum meant mortgage lenders were forced to issue multiple mid-day reprices (recalling previously available rates in favor of new, higher rate offerings).*
>
> *In the very best cases, some lenders are only .125% higher in rate (to put that in perspective, few individual days see bigger moves). Other lenders are closer to 0.25% higher. That puts today in a league with fewer than 10 players over the past decade. The average conventional 30yr fixed rate is easily up and over 4.25% now, with lenders anywhere from 4.375 to 4.625% depending on the scenario.*

You read that correctly. Lenders had to change mortgage rates multiple times in the same day and all rate changes were higher. This chart (below) from the article illustrates the one-year move in mortgage rates. Note that rates on a 30-year mortgage have moved from a low of 2.75% to about 4.5% presently.

On a $300,000 mortgage, that increases the monthly payment from $1225 per month to $1520 per month. That’s a jump of 24% per month. Combined with rising prices, many prospective home buyers will now be priced out of the market.

As forecast in the past, I expect that this trend will continue. The takeaway here may be that if you are looking to sell real estate, you probably want to move quickly. If you’re looking to buy and you can be patient, it may end up paying off.

The Medical Care Cost Bubble

A seldom-discussed topic is the cost of medical care which has been rising at a rate that is unsustainable. An undeniable truth, succinctly stated by the late economist, Herbert Stein, is that if something cannot go on forever, it will stop.

This will have to be true for rising healthcare costs at some point soon. The rate at which medical costs have risen since Medicare and Medicaid became realities in the 1960's has reached a level that is now, in my view, totally unsustainable.

Let's begin with examining actual spending on medical care. Since the US Dollar has lost much of its purchasing power over the last 50 years, measuring healthcare spending in terms of actual dollars spent would not provide a clear conclusion. It's more accurate to examine the percentage of gross domestic product that is spent on healthcare.

In 1960, healthcare expenditures were 5% of US Gross Domestic Product or economic output[8]. By 1970, after Medicare and Medicaid were implemented, healthcare spending increased by nearly 40% to 6.9% of GDP. By 2020, healthcare spending consumed about 20% of GDP, a truly eye-popping number. It's astounding that one in every five dollars of economic production goes to healthcare.

If you are looking for a reason for such a dramatic increase in healthcare spending, you may need to look no further than federal government spending on healthcare. According to the Associated Press[9], the government now

pays about 50% of all healthcare costs.

I don't need to tell you that when the government steps into an industry, cost-effectiveness steps out.

Per the Centers for Medicare and Medicaid Services[10], National Healthcare Expenditures averaged $12,530 per person in 2020, which was 19.7% of Gross Domestic Product.

Medicare spending grew 3.5% in 2020 to $829.5 billion and Medicaid spending increased 9.2% to $671.2 billion. Those two programs alone, which don't include all government spending for healthcare, totaled more than $1.5 trillion. That's about 38% of all collected federal tax revenues spent on just Medicare and Medicaid!

While I don't know where the ultimate breaking point for healthcare spending is, it's difficult to fathom spending more than 20% of GDP on medical care.

As far as government spending is concerned, I've previously discussed the fact that the Federal Reserve cannot abandon their easy money policies of low interest rates and currency creation until the federal budget is balanced or nearly balanced. With a current operating deficit of $3 trillion and more reckless, pork-laden spending recently occurring under the guise of keeping the government operating, we are a long, long way from a balanced budget.

At some point though, a balanced budget will have to be a reality. When that occurs, either proactively via massive spending cuts (unlikely) or reactively in response to a crisis (more likely), healthcare spending will have to be affected.

Bubbles are formed by easy credit. Easy credit is the fuel that inflates price bubbles. When the government took over much of the healthcare industry in the 1960's and began to provide easy credit, the bubble began to gradually build. At some point this bubble, like other bubbles will have to deflate.

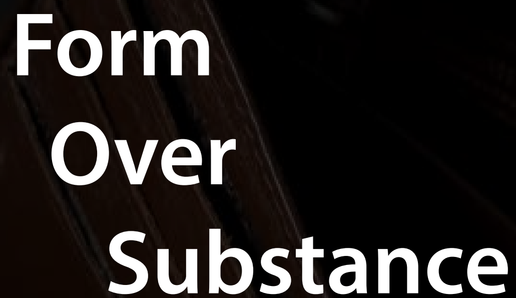
When it does, the healthcare of many Americans who are dependent on government expenditures to pay for their medical expenses, will dramatically change.

We are already beginning to see shifts in the way that healthcare is delivered. Two healthcare systems are now becoming reality. One system for those who depend on government expenditures to pay for their healthcare and one system for those who don't.

The Surgery Center of Oklahoma is an example of a surgical treatment center for those who want to bypass the traditional medical care system. A visit to the website[11] of the center informs you that the facility is operated by 40 top surgeons and anesthetists. Digging a little further, one can find the surgery that one needs and see the retail price of the surgery if performed at Surgery Center of Oklahoma.

This is far different from the traditional system where the cost of the procedure is determined by who is paying the bill.

Look for more medical professionals to gravitate toward the fee for service system and out of the traditional system as this bubble unwinds.



Form Over Substance

Many readers are undoubtedly aware of the recent interest rate hike by the Federal Reserve. On March 16, the Federal Reserve increased the Fed Funds rate by .25%.[12] The central bank said that it "anticipates that ongoing increases in the target range will be appropriate", pointing to future interest rate increases as well.

The Fed's Open Market Committee also stated it would begin to address it's $9 trillion balance sheet. In its post meeting statement, the Fed stated, "In addition, the Committee expects to begin reducing its holdings of Treasury securities and agency debt and agency mortgage-backed securities at a coming meeting."

As I have been suggesting, I believe this Fed action is more form than substance.

Inflation cannot be addressed effectively until real interest rates are positive. This move by the Fed is akin to using a garden hose to attempt to drench a blazing forest fire. It might look like you're addressing the problem, but there is no way you'll be effective.

When the Fed attempted a similar move in 2018, the markets reacted negatively. I expect the same market reaction this time should the Fed continue this course of action. Should that market reaction occur, I expect the Fed will once again reverse course.

April 2022 Special Report

Negotiating the Quadruple Threat: Devaluing Dollar, Sinking Stocks, Bubbling Bonds and Climbing Commodities. Strategies for a Crazy World

This month only, we are making available a free report titled, "Negotiating the Quadruple Threat: Devaluing Dollar, Sinking Stocks, Bubbling Bonds and Climbing Commodities. Strategies for a Crazy World."

To request your complimentary copy this month only, return one of the postage-paid reply cards included with this month's newsletter. You'll notice that we've included three reply cards with this month's newsletter; we've done that so you can request a copy of this report for anyone you know that might find this information helpful.

In this month's special report, you will discover:

- Forecast for stocks for the remainder of 2022
- A surprising bond market prediction
- An updated forecast for commodities
- Strategies for the current environment in light of these forecasts.

This report is available for the month of April only.

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At the time of publication, these rates were valid:

Term	Rate
1-Year	1.00%
2-Year	1.50%
5-Year	3.00%

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Resources to Help You Stay Informed

All these resources are available at the Retirement Lifestyle Advocates website: **www.RetirementLifestyleAdvocates.com.**

The weekly "Portfolio Watch" newsletter. Each week, I give you an update as to where we are economically speaking and in the financial markets and where we are going based on my analysis.

The weekly "Headline Roundup" webinar. Replays are available on the website. "Headline Roundup" happens every Monday live at Noon Eastern Time. To get an invite to the live event, give the office a call at **1-866-921-3613.**

The weekly "RLA Radio" show and podcast.

We also have the RLA app available. All these resources are also available on the app.

You can download the YOURRLA app for free by visiting the app store (either Google or Apple) and searching under YOURRLA.

If you have questions when downloading the app or would like assistance, feel free to call the office. Our office phone is answered 8 to 5 Monday through Thursday and 8 to Noon on Friday.

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