

THINGS THAT MAKE YOU GO *Hmmm...*

A walk around the fringes of finance



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“We’ve come to an agreement – we’re going to have another helping of dessert”

– ROBERT REISCHAUER, *FORMER CONGRESSIONAL BUDGET OFFICE DIRECTOR*

“Now we live, in a world of uncertainty
Fear is the key - to what you want to be
You don’t get a say, the majority gets its way”

– Iron Maiden, *Fear Is The Key*

dearth/dərTH/ n. A scarcity or lack of something

lead·er·ship/lee-der-ship/ n. The process of social influence in which one person can enlist the aid and support of others in the accomplishment of a common task

ab·di·cate (bd-kt) v. To relinquish (power or responsibility) formally

re·spon·sib·il·it·y [rɪˌspɒnsəˈbɪlɪtɪ] n. The state or position of being responsible

The obligation to carry forward an assigned task to a successful conclusion. With responsibility goes authority to direct and take the necessary action to ensure success

Well, here we all are again and this week, thankfully, my friends in Athens have had the good grace to keep their heads down and allow me the luxury of writing about something other than the goings-on in the Aegean Sea which, believe me, makes the most welcome of changes.

This week we are going to take a little look at a couple of subjects - one of which I wrote about last year when nobody seemed to be too interested in it but that suddenly has become one of the most important topics of discussion as we edge ever-closer to the US elections in November, and another which is something I think will ultimately decide how the Global Financial Crisis that began in 2007, reaches its denouement: oil and the world's government bond markets.

Back in September

when crude last found its way into the pages of Things That Make You Go Hmmm....., the discussion centred around the difference between the prices of WTI and Brent Crude and the curious fixation that America has on WTI as the rest of the world uses Brent.

At the time, the price of Brent had diverged significantly from its Cushing, Oklahoma-based

cousin and, as can be seen in the chart (below) that divergence was something that hadn't been seen even at the height of the run-up to \$145 in early-2008. A couple of weeks after I wrote about the widening spread in the two oil prices, it peaked and fell from 27.9 all the way to 8 and fears were allayed, but, as tensions have ratcheted higher in the gulf in recent weeks, that spread has begun to climb ominously once

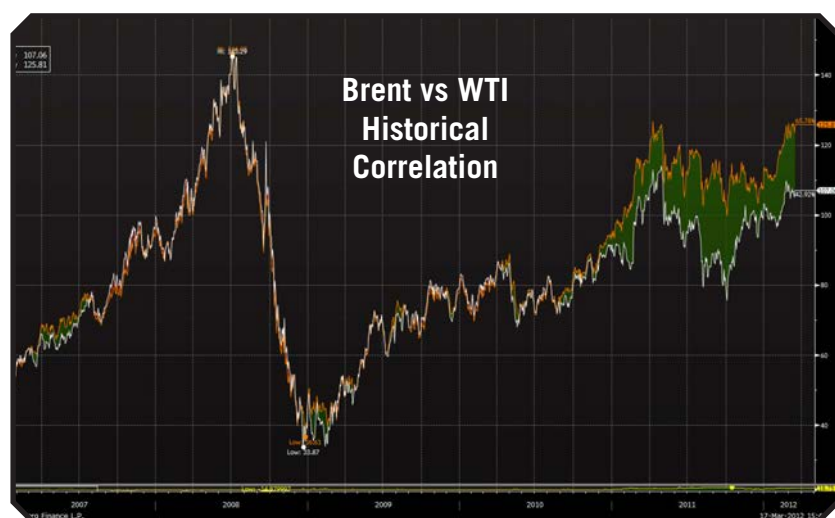


SOURCE: BLOOMBERG

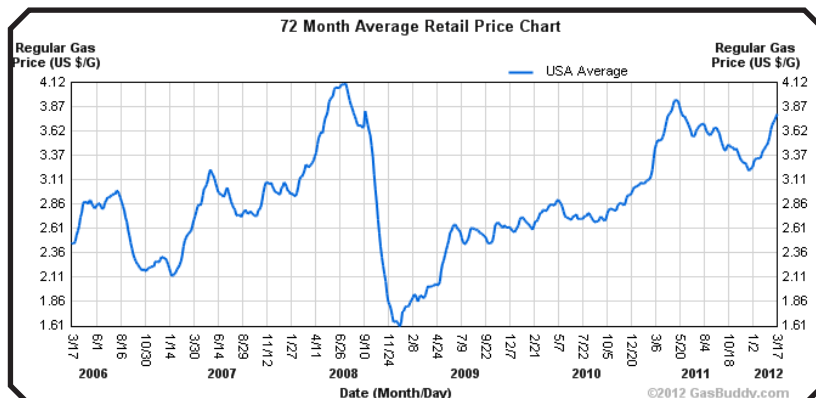
again, reaching a little under 20 this past week (chart, above).

Naturally, as the 'recovery' in the US struggles to gain enough real traction to provide proof positive that it is self-sustaining (in spite of the overwhelming amount of positive commentary that has been giddily bandied about in recent weeks), the last thing that is needed is high petrol prices (yes, petrol... I'm STILL English, get over it!!). But petrol prices have a funny habit of following oil prices higher and so it has been in recent weeks as the average price of a gallon of gas in the United States hit \$3.83 this past week (chart, following page) - inching ever closer to the magical \$4 level that seems to be the invisible line in the sand at which a concern becomes a catastrophe for US consumers.

Elsewhere in the world, oil has been making new record highs in currencies other than the US dollar and this has brought



SOURCE: BLOOMBERG



[CLICK TO ENLARGE](#)

SOURCE: GASBUDDY.COM

the commentators out in force. First up, in late February, Sterling:

(FT): Oil prices have soared to a record high in sterling terms and are approaching euro highs, raising fears that European countries struggling with heavy debts will face further barriers to economic recovery.

"This is a regional oil shock," said Amrita Sen, commodities analyst at Barclays Capital in London.

Brent rallied to £78.48 a barrel, passing the previous all-time high of £77.71 a barrel set in April last year at the peak of the Libyan civil war supply disruption. In euro terms, the oil benchmark reached a three-year high of €92.70 a barrel, a fraction below the peak of €93.50 a barrel set in July 2008.

A day later that 'fraction' disappeared and it was the euro's turn to make a new high:

(FT): Oil prices soared to a record high in euro terms, surpassing the peak touched in the 2008 price spike and posing a fresh problem for eurozone economies already struggling under the weight of the region's debt crisis.

The euro-denominated price of Brent crude, the global benchmark North Sea crude, rose to a peak of €93.63 a barrel on Thursday, surpassing the previous high hit on July 3, 2008. The new euro record comes just a day after Brent hit a record in sterling terms.

Of course, in the middle of an election cycle and with pump prices starting to get a little too high for political comfort, the leader of the House Democrats, Nancy Pelosi, dusted off the 2008 playbook and waded into the debate with the kind of hubris that has become commonplace when searching for someone to blame other than those who set the US' interest-rate policy. Take it away Nancy:

"Independent reports confirm that speculators are driving up the cost of oil, hurting consumers and potentially damaging the economic recovery. Wall Street profiteering, not oil shortages, is the cause of the price spike. In fact, U.S. oil production is at its highest level since 2003, and millions of acres have been cleared for additional development.

"We need to take strong action to protect consumers from this speculation. Unfortunately, Republicans have chosen to protect the interests of Wall Street speculators and oil companies instead of the interests of working Americans by obstructing the agencies with the responsibility of enforcing consumer protection laws. They have also repeatedly opposed our efforts to end billions of dollars in outdated taxpayer subsidies for oil companies enjoying record profits..."

(Break for a commercial about how wonderful the current administration is, how it is creating jobs in solar and green energy (funnily enough, no mention of Solyndra by name) and how much it is doing to reduce foreign oil dependence..... aaaaaand we're back):

"We call on the Republican leadership to act on behalf of American consumers and join our efforts to crack down on speculators who care more about their profits than the price at the pump even if these spikes harm the American consumer and our economy."

So there you have it. High gas prices are, like all high-priced objects, the fault of those most heinous of individuals; 'Evil Speculators'.

No mention of the roughly \$1.4 trillion in 'liquidity' pumped into the European banking system in the last 12 weeks, or the huge dollar swap lines put in place with various Central Banks around the world - or, for that matter, the fact that despite the rhetoric, the amount of oil being produced and the cost at which it is being pulled out of the ground are headed in different directions.

Since Pelosi's attack, however, things have gone from bad to worse and the price of gas has crept stubbornly higher as tensions over Iran ratchet up and the confidence starting to return to the collective psyche of the investing public threatens a return to ~~liquidity-induced asset inflation~~ rampant and thoroughly evil speculation.

We'll get back to that whole 'collective psyche' thing a little later, but for now let's stick with oil and examine the further response this past week to those higher prices.

After the attack on 'speculators' failed to lower gas prices (here's a piece of free advice by way of a simple mathematical equation for anybody in the current Administration who may be reading: $ZIRP \neq \text{Low Gas Prices}$), it was the turn of the other staple solution to an intractable problem; the US Strategic Petroleum Reserve (SPR):

(Montreal Gazette): A group of Democratic lawmakers in the U.S. House of Representa-

tives is again urging President Barack Obama to aggressively use the threat of releasing oil from emergency reserves to rain on speculators driving up oil prices.

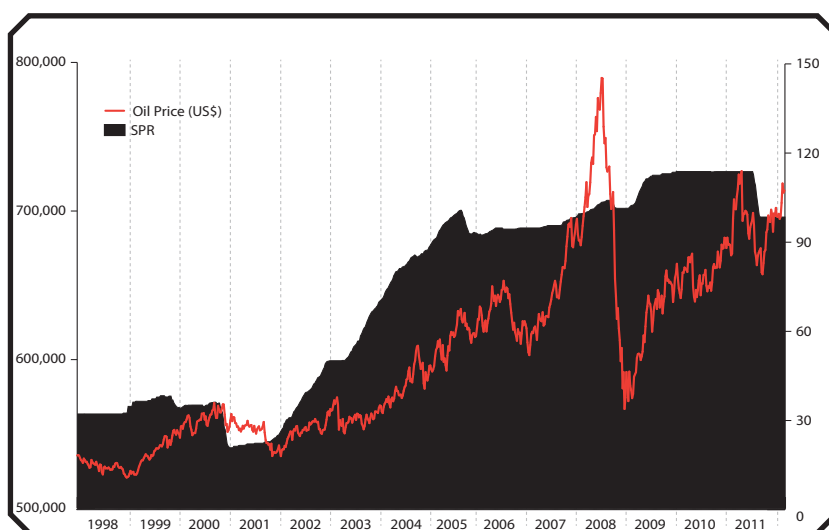
The three lawmakers are gathering signatures from others in Congress for a letter to Obama to press him to wield the 696 million barrels of oil that the government stores in salt caverns as a weapon against "rapid price escalations resulting from speculation in the oil markets."

Last June (the 24th to be precise), it was announced that 60 million barrels of oil would be released from world reserves, with about half of that amount being taken from the SPR. Oil was trading at \$91 when the announcement was made but actually rose in price - hitting \$97 - before dropping to \$88 once the surplus oil was introduced on July 15.

60 million barrels = \$3 lower price. Hardly bang for the buck - especially as oil was back above \$100 before the end of the year.

As much as the SPR is seen by many to be the panacea for high prices, the lack of available additional supply from the world's biggest producers is a far bigger concern; one which my friend Ronni Stoeferle from Vienna wrote a fantastic report on recently entitled "Nothing To Spare" (you can email Ronni [HERE](#) for a copy of the report which is an incredibly detailed piece of work). In it he took an in-depth look at some of the supply constraints facing the world and his conclusions are, to say the least, troubling:

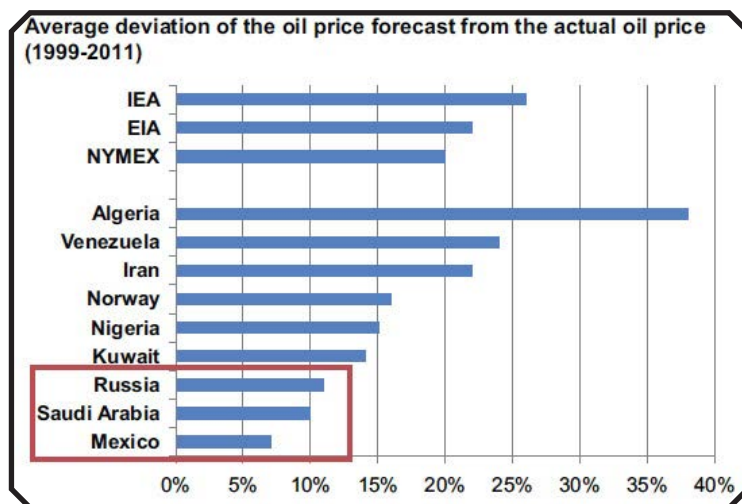
The still low reserve capacity makes the oil price vulnerable to geopolitical tensions. With the exception of Saudi Arabia, no country holds any significant reserve capacities. But since Saudi Arabia has never exceeded the barrier of 10 mbd on a sustainable basis, we harbor doubts as to whether the country can actually produce 12.5 mbd. Risks are that it will take a supply side crunch to find out whether the alleged reserve capacity actually exists to the extent proclaimed. At any rate, the



SOURCE: BLOOMBERG/TTMYGH

decision of IEA to tap the strategic reserves during the Libya crisis is a clear indicator of the strained supply situation.

Ronni goes on to examine the price forecasts of many major oil producers and their projections also point the way to higher prices:



SOURCE: ROLAND BERGER STRATEGY CONSULTANTS

A comparison of the oil price forecasts from various oil producers reveals that, in the period of 1999 to 2010 Mexico, Saudi Arabia, and Russia made the most accurate forecasts. All three of them also came closest to the actual price last year, which is why it makes sense to listen to their expectations. For 2012 they predict substantially higher oil prices. Saudi Arabia expects an average WTI price of USD 97, Mexico forecasts USD 116, and Russia USD 120/barrel. Iran has given the highest forecast at USD 137/barrel.

But these producers have their own problems - most notably the Gulf States who, in order to calm tempers amidst last year's Arab Spring, handed out billions of dollars to placate their angry citizens which has driven up their breakeven cost to between \$80 - \$90 per barrel. In fact, the sheer magnitude of the Saudi "stimulus package" was simply staggering. Ronni again:

The Saudi Arabian "Day of Rage" in March was without any consequences due to the generous governmental handouts. The eco-

nomie stimulus package worth USD 130bn contained a wage increase of 15% for civil servants, an increase in the minimum wage, cheques for two months' salary for civil servants, and an unemployment program. Almost USD 70bn will be invested in the construction of 500,000 social flats, and all mosques across the country will be renovated.

Overall, the package equals more than 20% of the Saudi Arabian GDP (by comparison, TARP in the US accounted for 5% of GDP).

Clearly, talk of speculators is (as it invariably is) a convenient attempt to find a scapegoat for a problem that doesn't sit well with the public (incidentally, in an in-depth study that I won't even bother conducting, it was proven that scapegoats are extra-convenient in election years), but the real problems are far more complex and far less solvable by policy - at least in the West.

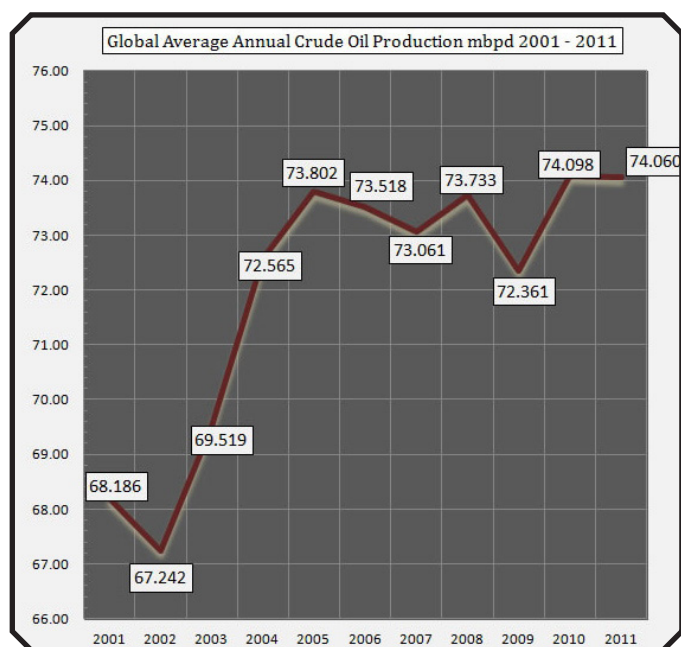
Whether you are a Peak Oil advocate or not, the issue with oil is clearly one of supply and capacity right now and, in an excellent recent article entitled ['Understanding The New Price Of Oil'](#) Gregor McDonald outlined just why supply is now primary:

Supply, and the recognition of supply, are now the dominant factor in the oil price. A point so obvious, it hardly seems worth making. However, the developed world is still largely operating on the classical economic view that higher prices will make new oil resources available.

That is true. But, it's just not true in the way most anticipate.

While higher prices have brought on new supply, these resources have been slow to develop, are more difficult to extract, and generally flow at lower rates of production. As the older oil fields of the world decline, the price of oil must reflect the economics of this new tranche of oil resources. There are no vast, new supplies of oil that will come on-line in 2013, 2014, and 2015 at the scale to negate existing global declines.

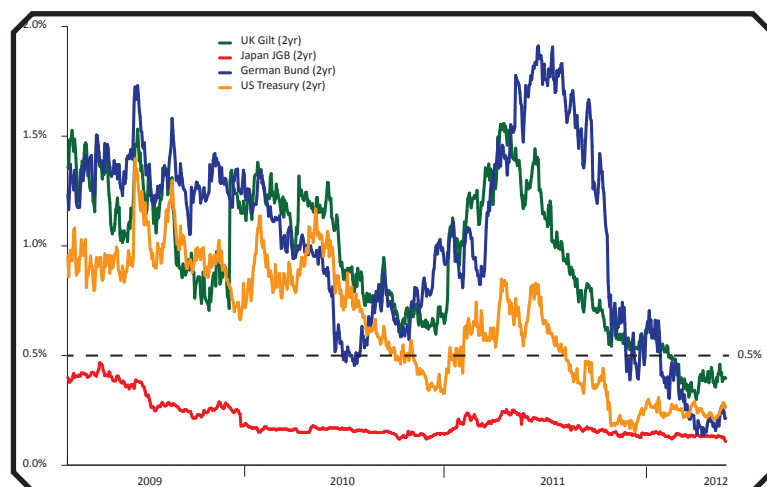
During the entire time that global oil supply has been held at a ceiling of 74 mbpd, since 2005, a lot of new production in the Americas and Africa especially has come online. But it



SOURCE: GREGOR/EIA WASHINGTON

has not been enough to increase total world supply. And the price of oil has finally started to price in that new reality.

Pricing in a new reality leads me back to the point I made earlier about the collective psyche of the investing public and, from there, to the other subject I wanted to discuss



SOURCE: BLOOMBERG/TTMYGH

this week; the government bond market.

For the last 4 years, since the world wobbled and threatened to fall apart, the world's central planners (and I use that term in the non-pejorative, uncapitalised sense) have been desperately trying to halt the meteoric rise of one precious commodity that has no tangible value - FEAR.

Fear sent investors stampeding into the government bond markets like never before and, as you can see from the graph (bottom, left), that has meant rates of virtually zero on 2-year money for the UK, Japan, Germany and the US. The interesting dichotomy is that over those 4 years, as the quality of the assets on their balance sheets steadily deteriorated, the cost of borrowing money became steadily cheaper and, whilst part of the reason for that is the policy of 'lower for longer' being adopted by Central Banks across the world, the main driver of those low, low rates is the f-word.

	5-yr	10-yr	30-yr
Japan	0.4%	1.0%	1.9%
Germany	1.0%	2.0%	2.7%
US	1.1%	2.3%	3.4%
UK	1.2%	2.4%	3.5%

SOURCE: BLOOMBERG

However, it's not *just* the short end of the curve that is currently enjoying an unprecedented feeding frenzy - as the table (above) illustrates.

All along the curve, thanks to a combination of low mandated rates and sheer terror, interest rates are being pinned at all-time lows which, considering the level of debt sloshing around the balance sheets of the governments in question, is no bad thing - in fact, it is ESSENTIAL that those rates stay exactly where they are for....well.... forever, really. Once they start to rise, the debts owed by sovereign powers very quickly become unsupportable and, we will find ourselves facing the very problem that all the 'F' was about - 'D' for Default.

Over the past few weeks the first subtle warning signs that things may be changing have been seen in a few charts of government bonds - most notably, perhaps, in the US (although Japan, too, is seeing what could be the start of meaningful moves higher). The chart below goes all the way back to 1980 and, for those of you too young to remember such times, yes, that is correct - those 10-year rates really WERE 16%. It CAN happen.



SOURCE: BLOOMBERG

Now, over the past several years, there have been many occasions when yields have started to look as though they could begin to rise and cause problems for governments and, each time, they have been sent tumbling again by either a further reduction in official rates, or fear of another catastrophic meltdown.

With government benchmark rates now effectively zero across the Western world (with the notable exception of Australia and New Zealand - well done guys, we'll see you down here soon) it has only been the fear component that has driven bonds up and yields down to all-time lows. The great Jim Grant summed it up as succinctly as only he can when he coined the perfect phrase for government bonds: Return-Free Risk.

In a Bloomberg article published this weekend, one paragraph summed up perfectly the rock and the hard place between which the Fed finds themselves jammed:

(Bloomberg): Treasury 10-year notes declined the most in eight months after the Federal Reserve drove investors into riskier assets and reduced speculation of further debt purchases by increasing its assessment of the U.S. economy.

No sooner does the Fed soften slightly their stance on the weakness of the US economy than a little bit more of the fear dissipates and the bond-selling begins in earnest - this is a particularly uncomfortable spot for them to be in.

Naturally, the first hint of an improvement in the US economy is enough to lead to renewed calls for QE3 and leading the way from his usual position at the front was Goldman Sachs' Jan Hatzius:

(WSJ): Goldman's top economist, Jan "Johnny the Hat" Hatzius was out with a note explaining why he thinks the Fed will announce some form of QE3 at either the April or June FOMC meeting.

"It has definitely become a closer call, but we still expect another asset purchase program that involves purchases of both mortgage-backed securities and Treasuries," he said...

...Mr. Hatzius is sticking to his guns. Here are his three reasons why additional Fed easing may still be warranted despite the improving data.

1. The improvement might not last.

With real GDP growth tracking just 2% in the first quarter and signs that at least some of the recent strength is probably due to the unusual warm weather and perhaps some seasonal adjustment distortions, question marks still surround the true pace of activity growth. In addition, there are still several actual or potential "headwinds" for growth, including a reduced boost from inventory accumulation, the recent increase in oil and gasoline prices, continued risks from the crisis in Europe, and the specter of fiscal retrenchment

after the presidential election.

2. Even if the improvement does last, faster growth would be desirable to push down the unemployment rate more quickly.

Fed officials believe that the level of economic activity and employment is still far below potential. This means a large number of individuals are involuntarily unemployed, which not only causes hardship in the near term but may also translate into higher structural unemployment in the long term...This creates an incentive to find policies that speed up the return to full employment.

3. Not easing might be equivalent to tightening.

At a minimum, the bond market currently discounts some probability of QE3. This has kept financial conditions easier than they otherwise would have been, which has presumably supported economic activity. A decision not to ratify expectations of QE3 could therefore result in a tightening of financial conditions.

And right there, in Jan's third point, is the nub.

The US economy has become so conditioned to easy credit conditions that merely to not supply more cheap money through further easing would be analogous to tightening.

Free money cannot go on forever and, no matter how manfully the Fed tries to create the perfect conditions, at some point one side is going to give.

The increase in the price of oil that is attracting so much attention currently is partly down to supply constraints, partly down to inflationary pressure and partly down to fear. The historic levels of interest rates are largely down to ~~supply constraints, inflationary pressure and fear.~~

With Greece 'solved', the European banking system propped up on LTRO largesse and, prima facie, the US economy starting to show signs of life, investors' fear of a systemic collapse (which was the only thing that drove them into government bonds at such frightening speed) is dissipating by the day and so, with all that firmly in mind, let me ask you a question:

If you lived in a world in which there was no chance of a systemic banking collapse, or a huge sovereign default leading to some kind of domino effect and in which the level of unemployment was falling, consumer confidence was rising, people were out spending money and corporates had, for the most part, extremely healthy, cash-heavy balance sheets - would you - knowing I had an overdraft of around \$15 trillion - lend me money for 2 years at 35 basis points? No? How about for 5 years at 1%? No?

Really?

The turn in the bond market is absolutely the most important thing to be watching for currently because when it comes, and once it picks up some steam there will be no stopping it. It will either end in financial repression or collapse - or both.

In the next decade alone, 29 countries (EU-17, US, China, Canada, Japan, UK, Brazil, India, Mexico, Australia, S. Korea, Turkey and Poland) will between them see \$36.8 TRILLION in debt maturities and, in a world without fear, the rates

EU-17	\$8.386 trn	Japan	\$11.699 trn
USA	\$10.247 trn	UK	\$1.833 trn
China	\$1.095 trn	Brazil	\$638 bln
Canada	\$632 bln	India	\$623 bln
Korea	\$367 bln	Mexico	\$497 bln
Turkey	\$282 bln	Poland	\$282 bln
Australia	\$204 bln		

SOURCE: GREG WELDON

at which they will need to refinance their borrowings will be markedly higher - too high, in fact, for many of them to be able to cope with. At that point in time, no amount of Quantitative Easing will be enough to fix the problems facing the world's central banks because once the fear of collapse turns to fear of the sovereign bond markets, the game is over.

This week's Things That Make You Go Hmmm..... features an excellent piece by Bob Fitzwilson of the Portola Group in which he examines the phenomenon of willing losers and the 'Great Game', David McWilliams takes up the topic of last week - Spain - and puts an Irish twist on it while Mike Shedlock calls a spade a pala (or, to put it another way: llamar al pan pan y al vino vino).

Angie Merkel is trying to find a better way of influencing the Eurogroup and that may mean a new job for Wolfie, Gallup is having real problems making the reality fit the numbers, China plans to import more uranium and we read the amazing account of one man's escape from a North Korean prison camp.

Talking of prison camps, Carmen Reinhart explains why financial repression is here - and here to stay, Central Banks take advantage of Central Bank-induced panic in the precious metals markets, Zerohedge looks at the mountain of money sitting on the sidelines just waiting for the all-clear signal and we read the fascinating story behind the surprising ouster this week of one of China's 'Princelings' Bo Xilai.

We have charts of inflation, California tax revenue shortfalls plus Richard Ross' take on the yen and the US 10-year bond pus interviews with Ben Davies, Martin Armstrong and Jim Grant. There is also time for a look back

in authentic 1980s style to the Hunt Brothers' attempts to corner the silver market.

Lastly, I chatted with Al Korelin yesterday about many of the points raised in this week's Things That Make You Go Hmmm..... and he has posted the interview already so for those of you interested in listening, you can find it [HERE](#)

That's just about it from me, but before I go, two brief acknowledgments. The image on the cover of this week's edition is courtesy of a cartoon I was sent by 'Bennett' and was published in the Christian Science Monitor, while last week I included a cartoon that was unattributed. Subsequently I have been informed by several readers that the cartoon was published by Jim Grant so I wanted to rerun it with correct attribution. Fortunately, it is as funny this week as it was last.

I'll see you all again next week.



SOURCE: JIM GRANT

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18 March 2012

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Bo Bo Black Sheep

Charts That Make You Go Hmmm.....

Words That Make You Go Hmmm.....

And Finally.....



As I began my career in the 1970s, a wise investor told me that the best investment arenas involve willing losers. This particular person had made a great deal of money in commodities. He told me that the classic candidates for willing losers throughout history are governments. Governments are willing to lose in attempting to maintain national pride or to pursue the retention of political power. In trying to provide context for what we are witnessing in the paper and physical metals markets, I was reminded of this sage advice given to me long ago.

The 1970s held the same features as we see today. It began with uncontrolled printing in the mid-60s with the pursuit of both "Guns and Butter" as it was called. The U.S. was trying to create the Great Society and fight the Vietnam War at the same time.

It led to a race for precious metals, primarily gold. President De Gaulle of France was one of the first to recognize that the rampant printing would begin to destroy the value of the U.S. dollar and demanded that France's holdings of dollars be exchanged for gold. It was De Gaulle that

"...Rampant money printing, a race for oil and a scramble for precious metals.... sounds familiar, doesn't it? So here we are again..."

forced Nixon's hand in terminating the conversion of paper money for U.S. gold in 1971.

Consequently, we saw a dramatic increase in the price of oil. The Arabs also realized that the value

of the dollar was going down, and rightfully demanded a higher price per barrel.

Rampant money printing, a race for oil and a scramble for precious metals.... sounds familiar, doesn't it? So here we are again. This time, it involves the whole planet and truly massive printing.

Returning to gold and silver, the battle is being fiercely fought. The willing losers are governments, of course, a sub-set of the hedge fund world, individuals speculating in the paper markets and holders of physical metals that become

scared and sell their positions.

Governments are losers, as they no longer care about the value of currencies. Their goal is to dampen the volatility of the price increases, not the ultimate ascent. Jim Sinclair has been very eloquent in pointing this out.

Hedge funds are losers, too. In general, investors in hedge funds are chasing a dream of aggressive returns in exchange for paying above normal fees. One way for the funds to have a chance at aggressive returns is to use maximum leverage in the paper gold and silver markets. For most of them, there is no intention to own physical metals. The paper markets are simply a leveraged, computer driven poker game. When the hedge funds move, they tend to move together, both in and out of the market, often at the wrong times.

★ ★ ★ BOB FITZWILSON / EMAIL

China plans to import more uranium this year than last year and to buy uranium mines abroad, looking particularly toward Canada for that purpose, said Qian Zhiming, deputy director of the National Energy Administration.

Qian also said China might resume undertaking nuclear projects this year, in the first half of the year at the earliest. He said the Chinese government has finished drafting the nuclear safety guidelines that it began working on after a devastating earthquake and tsunami struck Japan a year ago, crippling the country's Fukushima Dai-ichi nuclear plant.

Even though that disaster prompted the country to halt any work being undertaken on new nuclear projects, China imported 16,126 tons of uranium in 2011, not much less than the 17,135 tons it had imported in 2010, according to the General Administration of Customs.

Qian said the import amount will remain the same as last year, or even be increased, in 2012.

The soonest that resumption of nuclear projects will happen, Qian said, is in the first half of the year.

Wang Binghua, chairman of State Nuclear Power Technology Corp, said last Saturday at a news briefing that China will resume approving and building new nuclear projects in 2012. The government also has completed a safety inspection that revealed 14 nuclear safety issues that should be remedied.

Following the nuclear leak that struck Japan last year, the Chinese government announced it would temporarily cease approving nuclear power stations. Around the same time, it began to conduct safety checks at both existing nuclear plants and those that were under construction.

Because of those decisions, no new nuclear project was either approved or started in China last year.

Premier Wen Jiabao, in an annual government work report delivered on March 5, said China will “develop nuclear power in a safe and efficient way” this year, saying the country will “prohibit blind expansion in the new-energy industries of solar and wind power”.

In December, new nuclear safety guidelines for China were submitted to the State Council. Officials are still drafting guidelines for developing nuclear power in the mid- and long-term.

China began operating its first commercial nuclear plant in 1994. The country, which has 15 nuclear reactors, is now building at least 25 reactors and has 50 more planned, according to the China Nuclear Energy Association.

The prospect that nuclear projects will be started again this year is not the only reason behind China’s prediction that it will import more uranium in 2012.

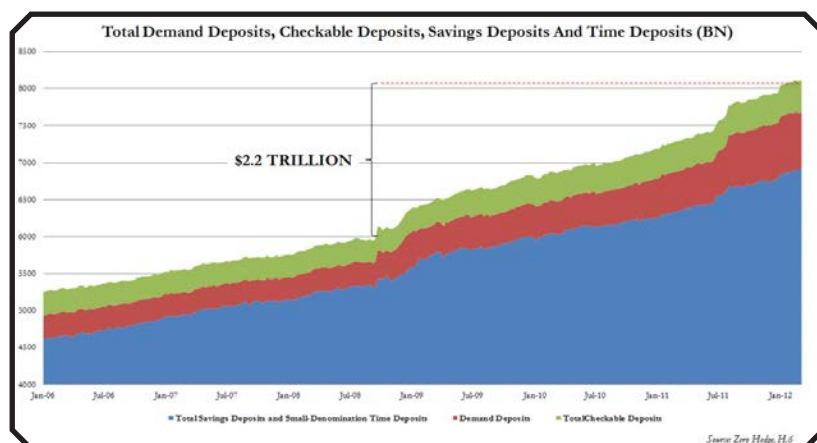
Another is the likelihood that “a few overseas mines will start production this year,” according to Xiao Xinjian, industry expert at the Energy Re-

search Institute, which is affiliated with the National Development and Reform Commission.

Of all the countries that supply uranium to China, the top four exporters are Kazakhstan, Uzbekistan, Namibia and Australia. They contributed more than 95 percent of China’s imports of that element last year.

★ ★ ★ CHINA DAILY / [LINK](#)

Alas, the damage has been done: between the Great Financial Crisis, the Flash Crash, a massively corrupt regulator, re-hypothecating assets that tend to vaporize with no consequences, and a central bank which effectively has admitted to running a Russell 2000 targeting ponzi scheme, the investor is gone. But what if? What if the retail herd does, despite everything, come back into stocks? After all the money is in bonds, or so the conventional wisdom states. What harm could happen if the 10 Year yield goes back from 2% to 3%, if the offset is another 100 S&P points. After all it is good for the velocity of money and all that - so says classical economic theory. Well, this may be one of



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SOURCE: ZEROHEDGE

those “be careful what you wish for.” Because while investors have indeed park hundreds of billions out of stocks and into bonds, the real story is elsewhere. And the real story is the real elephant nobody wants to talk about. Presenting: America’s combined cash hoard, which between total demand deposits, checkable deposits, sav-

ings deposits, and time deposits (source H.6), is at an all time high of \$8.1 trillion.

Indicatively, this consolidated number was a modest \$5.9 trillion the week when Lehman failed. In other words, in the period in which the Fed dumped \$1.6 trillion in cash on Primary Dealers' balance sheets, and gave them a carte blanche to buy NFLX, AAPL, and Crude of course, which they did in keeping with the Fed's Global Put mandate, i.e., no bank will ever fail again, American consumers added \$500 billion more than even the Fed parked with the banks, or \$2.2 trillion.

And therein lies the rub. As a reference, America currently has about \$1 trillion of currency in circulation. If, and this is a big if, the gullible US consumer-cum-New Normal investor, does fall for the oldest herding trick in the book, and not only converts their bond holdings but their cash holdings into stocks, which in turn goes right into money velocity, into currency, and thus, into inflation, America may promptly find itself with the most unprecedented inflationary outcome it has ever experienced.

★ ★ ★ ZEROHEDGE / [LINK](#)

A careful look at the government's unadjusted household unemployment data shows a stunning 740,000 jobs added to the economy in February -- three times the 227,000 reported based on the establishment payroll survey. If this is economic reality, then the underlying economy must be growing much faster than most Americans currently believe. If the U.S. economy is surging, and jobs increased at the

rate of three-quarters of a million last month, why haven't we heard a lot more about it? And, given a rapidly expanding economy, how can Gallup's nearly 30,000 random interviews with Americans across the nation show a significant increase in the unemployment rate?

According to the government's household survey, the number of employed Americans increased 740,000 to 140.684 million in February from 139.944 million in January. This increase of three-quarters of a million jobs is how the unadjusted unemployment rate was 8.7% in February compared with 8.8% in January, even as the U.S. workforce increased by 629,000 employees and the number of unemployed Americans fell by 111,000.

On the other hand, a comparison of February's household survey results to the government's December 2011 unadjusted unemployment data suggests a much more modest improvement in jobs and the U.S. economy over the past two months. The number of employed Americans increased by 3,000 on an unadjusted basis between February 2012 (140.684 million) and December 2011 (140.681 million). On the same basis, the number of unemployed Americans increased by 738,000 to 13.430 million in February 2012 from 12.692 million in December 2011. The U.S. workforce increased by 741,000 over these two months. The government's unadjusted unemployment rate increased to 8.7% in February 2012 from 8.3% in December 2011.

This morning on CNBC, there was discussion about how the increase in payroll survey jobs is hard to reconcile with economists' growth estimates for the U.S. economy. If the payroll jobs numbers are right, then the economy is growing faster than estimated, or maybe, productivity is plunging. Of course, if there are questions about how we reconcile payroll jobs with other economic data, making economic sense of the household survey surge in jobs is even more difficult.

★ ★ ★ GALLUP / [LINK](#)

BLS Household Employment Data, January-February 2012

Not seasonally adjusted; numbers in thousands

	February 2012	January 2012	January to February 2012 difference
Civilian labor force	154,114	153,485	+629
Employed	140,684	139,944	+740
Unemployed	13,430	13,541	-111
Unemployment rate	8.7%	8.8%	-0.1%
Participation rate	63.6%	63.4%	+0.2%

GALLUP

As they have before in the aftermath of financial crises or wars, governments and central banks are increasingly resorting to a form of “taxation” that helps liquidate the huge overhang of public and private debt and eases the burden of servicing that debt.

Such policies, known as financial repression, usually involve a strong connection between the government, the central bank and the financial sector. In the U.S., as in Europe, at present, this means consistent negative real interest rates (yielding less than the rate of inflation) that are equivalent to a tax on bondholders and, more generally, savers.

In the past, other measures also included directed lending to the government by captive domestic entities (such as pension funds or banks), explicit or implicit caps on interest rates, regulation of cross-border capital movements, and (generally) a tighter coordination between governments and banks, either explicitly through public ownership of some institutions or through heavy “moral suasion” by officials.

Central banks in both developed and developing countries are being subjected to complementary pressures. Emerging markets may increasingly look to financial regulatory measures to

economies have incentives to keep capital “in” and create a domestic captive audience to absorb the financing for the high existing levels of public debt.

Concerned about potential overheating, rising inflationary pressures and the related competitiveness issues, emerging-market economies may continue to welcome changes in the regulatory landscape that keep financial flows at home. Indeed, this trend is already well under way. This concern means advanced and emerging-market economies are finding common cause in increased regulation and/or restrictions on international financial flows and, more broadly, the return to more tightly regulated domestic financial environments.

This scenario entails both a process of financial deglobalization (the reappearance of home bias in finance) and the re-emergence of more heavily regulated domestic financial markets.

★ ★ ★ CARMEN REINHART / [LINK](#)

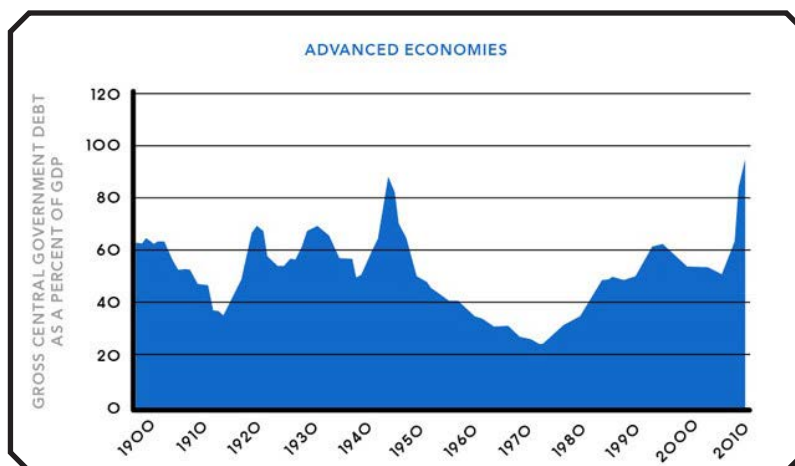
His first memory is an execution. He walked with his mother to a wheat field, where guards had rounded up several thousand prisoners. The boy crawled between legs to the front row, where he saw guards tying a man to a wooden pole.

Shin In Geun was four years old, too young to understand the speech that came before that killing. At dozens of executions in years to come, he would listen to a guard telling the crowd that the prisoner about to die had been offered “redemption” through hard labour, but had rejected the generosity of the North Korean government.

Guards stuffed pebbles into the prisoner’s mouth, covered his head with a hood and shot him.

In Camp 14, a prison for the political enemies of North Korea, assemblies of more than two inmates were forbidden, except for executions. Everyone had to attend them.

The South Korean government estimates there



[CLICK TO ENLARGE](#)

SOURCE: BLOOMBERG

keep international capital “out” (especially given the expansive monetary policy stance pursued by the U.S. and Europe). Meanwhile, advanced

are about 154,000 prisoners in North Korea's labour camps, while the US state department puts the number as high as 200,000. The biggest is 31 miles long and 25 miles wide, an area larger than the city of Los Angeles. Numbers 15 and 18 have re-education zones where detainees receive remedial instruction in the teachings of Kim Jong-il

"The South Korean government estimates there are about 154,000 prisoners in North Korea's labour camps, while the US state department puts the number as high as 200,000

and Kim Il-sung, and are sometimes released. The remaining camps are "complete control districts" where "ir-redeemables" are worked to death.

Shin's camp, number 14, is a complete control district. Established around 1959 near Kaechon County in South Pyongan Province, it holds an estimated 15,000 prisoners. About 30 miles long and 15 miles wide, it has farms, mines and factories threaded through steep mountain valleys.

Shin and his mother lived in the best prisoner accommodation the camp had to offer. They had their own room, where they slept on a concrete floor, and they shared a kitchen with four other families. Electricity ran for two hours a day. There were no beds, chairs or tables. No running water.

If Shin's mother met her daily work quota, she could bring home food. At 4am, she would prepare breakfast and lunch for her son and for herself. Every meal was the same: corn porridge, pickled cabbage and cabbage soup. Shin was always hungry and he would eat his lunch as soon as his mother left for work. He also ate her lunch. When she came back from the fields at midday and found nothing to eat, she would beat him with a shovel.

Her name was Jang Hye Gyung. She never talked to him about her past, her family, or why she was in the camp, and he never asked. His existence as her son had been arranged by the guards. They chose her and the man who became Shin's father as prizes for each other in a "reward" marriage.

★ ★ ★ *UK GUARDIAN* / [LINK](#)

Few indicators could have underscored the inconsistency at the heart of the eurozone than figures yesterday showing Germany's investor confidence at a 21-month high, while Spain, wracked by 22pc unemployment, gives the EU the two fingers on the fiscal compact.

Here we have Europe's biggest economy, Germany, cruising ahead and bathed in lots of free capital from the ECB; while Spain, the world's 12th richest country is in a heap. It is impossible to see how a currency union between such large countries going in such opposite directions can last.

The reason for the difference is that Germany and German investors have benefitted enormously from being a creditor nation over the past 10 years, while Spain — a large version of Ireland — has had a similar property slump and its banks are now bust and all the free money in the world from the ECB isn't going to make it any better soon. As the wonderfully prescient John Mauldin in his financial newsletter (www.johnmauldin.com) said this week, Spain's GDP of \$1.4trn (€1.07trn), somewhat surprisingly perhaps, puts it just behind oil-rich Russia and Canada and people-rich India.

Spain is a big country. Spain matters. Spain does indeed matter and this is why the move by the Spanish government yesterday to tell the Merkozy where to go is an interesting development.

The new Spanish prime minister, Mariano Rajoy, signed the fiscal compact, flew back to Madrid and then promptly rejected the first obligation of the fiscal compact which compelled him to rapidly reduce his budget deficit. The Spaniard realised that with the country in difficulty, too much budget retrenchment would tip it over.

Like Ireland, the major issue is not just the public debt, but the private sector debt which stands at a staggering 227pc of GDP and, according to McKinsey (a report we quoted here in this column a few weeks back), Spanish corporations hold twice as much debt relative to their output

as US companies and, in comparison to Germany, that number goes up to six times.

So Spain, much more than Greece, is a big Mediterranean version of Ireland with huge, private debt. We would be wise to watch what the Spaniards do next. It is clear that the Greek deal of last Friday will no more ring-fence Europe's debt crisis than the last bail-outs. What it has done is bought a little time for the EU.

Spain is choosing to use that time to loosen the noose around its neck. It also realises that there is very little the EU can do and with two votes coming up — a presidential one in France and the Irish referendum — anything can happen.

The Germans on the other hand are hoping that they have done just enough to quarantine Greece and make Europe safe for German companies to export to without the trouble of yet more defaults on the periphery. What Germany fails to understand is its huge trade and current account surplus with the rest of Europe is as much a problem as Spanish or Irish debt.

★ ★ ★ DAVID MCWILLIAMS / [LINK](#)

While noting that Spanish banks are betting heavily on the success of the LTRO, please note strong evidence that Spain's debt-to-GDP ratio is wildly understated because it does not include regional debt, nor does it include government guaranteed bank debt and other miscellaneous items.

Please consider these snips from [The Fool's Game: Unraveling Europe's Epic Ponzi Pyramid of Lies](#) by Zero Hedge:

If we just take the newest figures for Spain, which were released this morning, we find an admitted sovereign debt of \$732Bn and a touted debt to GDP ratio of 68.5% which is up 10.7% from last year.

In a report issued on 2/29/12 and apparently ignored by everyone including the rat-

ings agencies, Eurostat reports that Spain has total sovereign guarantees of "other debt" which is 7.5% of their total GDP which

Admitted Sovereign Debt	\$732 billion
Admitted Regional Debt	\$183 billion
Admitted Bank Guaranteed Debt	\$103 billion
Admitted Other Guaranteed Debt	\$72 billion
Total Admitted Debt	\$1.09 trillion
A More Accurate Debt to GDP Ratio	113.2%

would total around another \$72.2 billion in uncounted debt. Then if we consider [all] the "known" debt we find:

In the same Eurostat report, by the way, of 2/29/12 we also find that Belgium's sovereign guarantee of "other debt" is 21.3% of their GDP, for Italy it is 3.6% of their GDP and for Portugal the number is 7.7% of their GDP. This does not include any guarantees of bank debt which would also have to be added in to the totals to reflect some sort of accurate fiscal picture. Consequently, as investors, we are not in some murky place but smack dab in a carefully engineered plan of outright Fraud where we are given manipulated and inaccurate numbers in the hopes that we will fund based upon them.

Not only are published GDP figures a lie, so are published debt figures. The result is a complete farce in debt-to-GDP accounting.

Meanwhile Spanish banks continue to plow into leveraged debt on their own bonds, with Spanish unemployment over 23%, with youth unemployment of 49%, with widening regional debt problems, with massive unrecognized housing sector losses, and with more austerity measures coming that will exacerbate all of the previously mentioned problems!

This Ponzi scheme cannot last, which means it

won't. Spain will implode. Indeed, it's a wonder it hasn't already.

★ ★ ★ MIKE SHEDLOCK / [LINK](#)

German Chancellor Angela Merkel is reportedly pushing for her finance minister to be the next head of the Euro Group, the informal body that governs Europe's common currency. But Wolfgang Schäuble could face resistance from France over fears that Germany is becoming too powerful.

Jean-Claude Juncker has been open for some time now about the fact that he may not seek to renew his term as president of the Euro Group, the 17-country panel that oversees Europe's common currency. For weeks, names have been

"The game isn't over yet," a high-ranking EU finance official told the newspaper, who also indicated there is French resistance to Schäuble. "Sarkozy fears that the German position could be strengthened,"

bandied about over a possible successor to Luxembourg's prime minister, who has often been at odds with Germany over Berlin's policies on the common currency. Now, German Finance Minister Wolfgang Schäuble's name has been tossed into the ring, according to a report in the Friday edition of the

Financial Times Deutschland.

The newspaper reports that Angela Merkel has been lobbying other European leaders to appoint Schäuble, a member of the chancellor's conservative Christian Democratic Union (CDU) party, to the position. On Friday, however, the government declined to comment on the report.

Citing an insider, the Financial Times Deutschland reported that Schäuble would be the first choice to head the informal group if a European leader isn't selected. "He's got the best cards at the moment," the source said. Both Finnish President Jyrki Katainen and Italian Prime Minister Mario Monti, who is also Italy's finance minister, recently turned down the position. If Schäuble were to be appointed, it would also be possible for him to continue on as Germany's finance

minister.

In May, Juncker, who has headed the Euro Group since 2005, signalled he wanted to leave his post. His term is scheduled to end in June. There's still a possibility he will renew his term, but the 57-year-old leader has indicated he is overworked and wants to pull back.

The Financial Times Deutschland is reporting that a decision on the post could be delayed until May because of the French presidential election. "The game isn't over yet," a high-ranking EU finance official told the newspaper, who also indicated there is French resistance to Schäuble. "Sarkozy fears that the German position could be strengthened," he said. Sources with information about the Euro Group's inside dealings told the paper that Sarkozy's opposition to Juncker, with whom he has often sparred, has softened after Merkel began promoting Schäuble as a possible successor.

Earlier this week, Schäuble said he believed that the next Euro Group president should come from a country in the euro zone with a top credit rating. That list of countries is a very short one: Besides Germany, it includes Luxembourg, Finland and the Netherlands. The so-called AAA countries would be "best suited to present a candidate," the CDU politician told a Dutch newspaper.

★ ★ ★ DER SPIEGEL / [LINK](#)

The Bank for International Settlements, which acts on behalf of central banks, has been buying significant quantities of gold on the international market amid falling prices, traders said.

According to several estimates, the BIS bought 4-6 tonnes of gold, worth roughly \$250m-\$300m at current prices, in the over-the-counter physical market last week, with purchases particularly strong at the end of the week. The total purchases over the past three or four weeks were likely to be as much as double that, the traders added.

In a note to clients this week, Credit Suisse re-

ferred to “aggressive central bank buying seen last Friday”...

As a group, they made their largest purchases of gold in more than four decades last year, led by emerging economies such as Mexico, Russia and South Korea intent on diversifying their dollar-heavy foreign exchange reserves. The World Gold Council has also pointed to the possibility of significant unreported purchases by China at the end of last year.

At the same time, European central banks have all but halted a run of large sales.

“Central banks have definitely been looking at gold as an asset class much more closely ever since European central banks stopped selling,” a senior gold banker said. “There has been a huge interest.”

While some countries, such as Russia, China or the Philippines, have traditionally accumulated gold produced by their domestic mining industry, others use the BIS as an agent to carry out purchases and sales on their behalf, preserving anonymity.

The central bank buying comes as gold prices have slid in the past three weeks as strong economic data from the US has lowered investors’ expectations of quantitative easing by the Federal Reserve and made other investments, such as equities, appear more attractive.

★ ★ ★ *FT (VIA ZEROHEDGE)* / [LINK](#)

Official reports were as terse as usual: Bo Xilai, the party chief of the south-western region of Chongqing, had been replaced by a deputy prime minister, Zhang Dejiang. Until recently Mr Bo appeared destined for a job at the pinnacle of power in Beijing. The news, issued without explanation on March 15th, was a stark indication of strife at the highest level of Chinese politics.

It was far from unexpected. Mr Bo’s political prospects had slumped on February 6th, when a deputy mayor and former police chief of Chongqing, Wang Lijun, Mr Bo’s right-hand

man in a very public campaign against organised crime, fled to an American consulate and spent a day there. Both American and Chinese officials have kept mum about what happened inside. Mr Wang walked out of the consulate into custody after Chongqing’s mayor, Huang Qifan, had gone in to talk to him. Since then it has been widely thought the real point of the investigation into Mr Wang was to undermine Mr Bo himself.

Since the Tiananmen Square protests in 1989, the Communist Party has been at pains to keep its power struggles under wraps. It was partly the awareness of high-level infighting that emboldened citizens to join the protests that year. The drama in Chongqing suggests the facade of unity may crack, as younger leaders less involved in the struggles of the 1980s compete for top positions. Late this year the party is due to hold its five-yearly congress, at which seven out of the nine members of the ruling Politburo’s standing committee are expected to be replaced. Mr Bo was long reckoned to be a contender for one of those slots.

No longer. A day before his sacking, Wen Jiabao, the prime minister, had rebuked Mr Bo publicly in a way not heard between Politburo members since the 1980s. At a news conference at the end of a ten-day annual session of China’s parliament, the National People’s Congress (NPC), Mr Wen said Chongqing’s leaders should “reflect” on the Wang Lijun case. In China’s guarded political language, that was a stinger.

★ ★ ★ *THE ECONOMIST* / [LINK](#)

Inquiring minds have noticed a huge plunge in California Tax Revenue for the month of February compared to February 2011.

That is a 22.55% plunge in spite of the fact that this February was a leap year adding a day to the calendar.

Madeline Schnapp, at TrimTabs Investment Research sent me a quick note regarding that plunge a few days ago.

California Tax Revenue Feb 2012 vs. Feb 2011	Month of February	
	2012	2011
REVENUES		
Alcoholic Beverage Excise Tax	\$ 21,829	\$ 19,619
Corporation Tax	84,861	136,046
Cigarette Tax	1,453	1,219
Estate, Inheritance, and Gift Tax	716	392
Insurance Companies Tax	19,560	11,492
Personal Income Tax	1,659,107	1,986,997
Retail Sales and Use Taxes	2,426,282	3,238,757
Vehicle License Fees	2,573	102,386
Pooled Money Investment Interest	-	1,147
Not Otherwise Classified	169,250	164,535
Total Revenues	4,385,631	5,662,590

SOURCE: MISH

Madeline writes...

Hello Mish

I came across this little tidbit from the February report from the Comptroller's office of the State of CA.

In Feb 2012 income tax receipts are down \$328 million y-o-y, or 16.5%. Ouch!

What about retail sales taxes? CA had a "temporary" sales tax hike of one cent that expired last July. Adjust the data to reflect that change, it looks like sales taxes in February are \$400 million y-o-y +/-, a decline of about 12.4%. Double ouch!

That doesn't sound like robust growth to me.

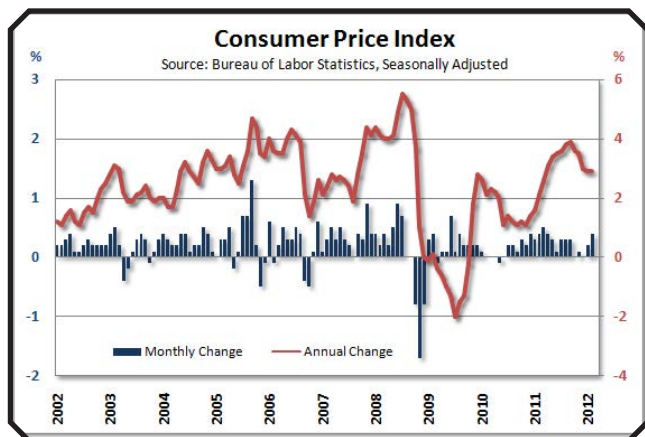
★ ★ ★ MIKE SHEDLOCK / [LINK](#)

The Reuters/University of Michigan consumer sentiment index dipped from 75.3 in February to 74.3 in the first of two readings for March in a sign that rising gas prices may now be having in an impact on the mood of the consumer (chart, below right).

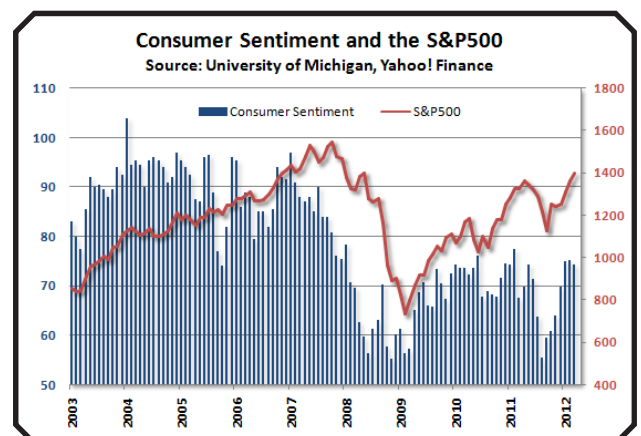
The Labor Department reported that, paced by the surging cost of energy products, consumer prices in the U.S. jumped 0.4 percent last month and, on a year-over-year basis, inflation was unchanged at 2.9 percent (chart, below left).

Gasoline prices surged 6.0 percent in February and are now up 12.0 percent from a year ago as the energy index jumped 3.2 percent, now 7.0 percent higher on a year-over-year basis.

★ ★ ★ TIM IACONO / [LINK](#)



SOURCE: TIM IACONO



SOURCE: TIM IACONO

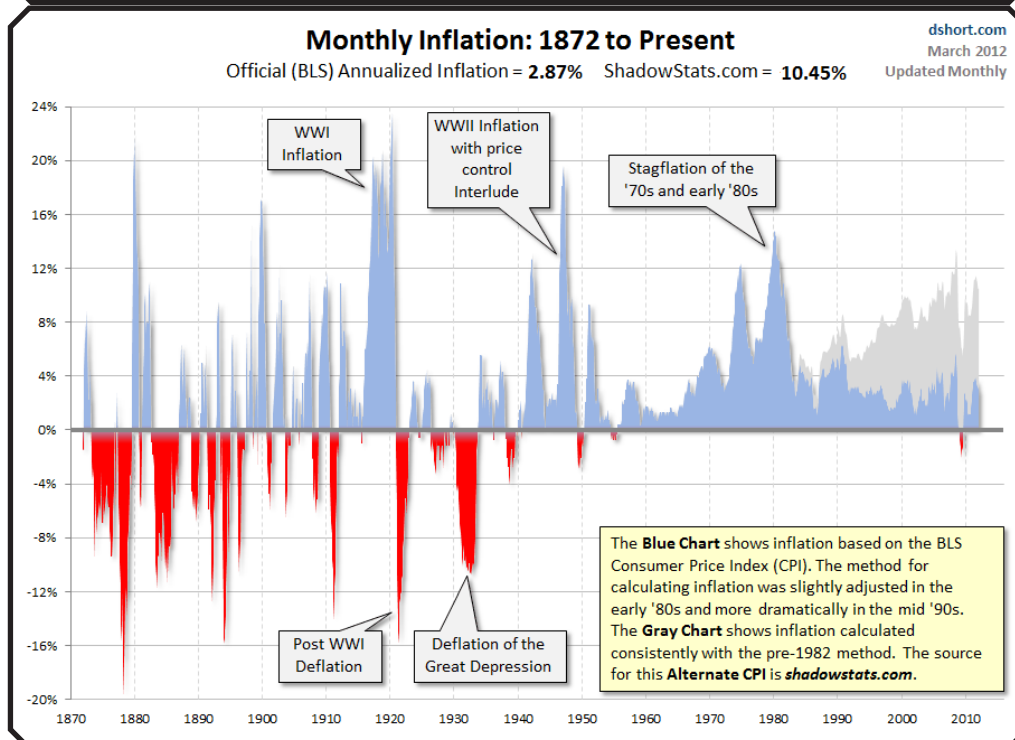
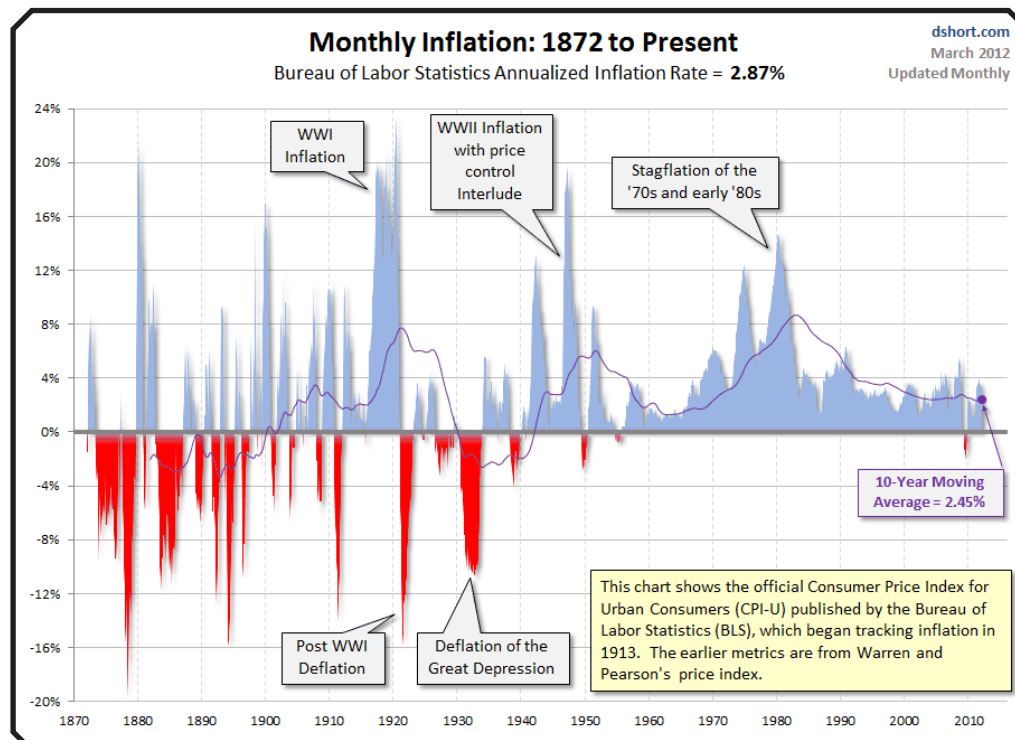
In yet another tour de force, Richard Ross of Auerback Grayson tears through all the key charts you need to be watching this week. Below are a couple that I have been personally watching VERY closely for a while now - the US 10-year Treasury and the Japanese Yen, but, as always, there is so much more on Richard's radar screen and it is all delivered with such panache - how could you NOT want to see the rest?

Email Richard [HERE](#)



SOURCE: BLOOMBERG/RICHARD ROSS

The March 2011 Consumer Price Index for Urban Consumers (CPI-U) released today puts the February year-over-year inflation rate at 2.87%, which is over a full percent below the 3.95% average since the end of World War II.



Two looks at inflation numbers courtesy of Doug Short. Above, the headline BLS representation and below that of John Williams' Shadowstats.

CLICK TO ENLARGE

SOURCE: DOUG SHORT

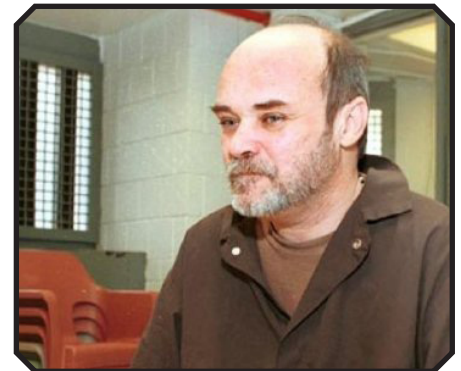


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Nelson Bunker Hunt is a familiar face to any followers of the silver market. In this fantastic clip (courtesy of a friend in Sydney - thank you Peter), takes us back to a time of wide lapels, large-framed glasses, cigars, TV studio sets that cost less than \$100 to build and \$50/oz silver.

My guess is that one of those things could be coming back...

Jim Puplava welcomes back Martin Armstrong. Martin believes "capital knows something is wrong" and we're past the tipping point of the debt crisis. He sees the crisis rotating from Europe to Japan and finally reaching the US, with devastating results. As to gold, he believes the best thing for gold would be a correction this year and a healthy period of consolidation, setting the stage for a launch higher as the debt crisis worsens.



[CLICK TO LISTEN](#)



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Regular visitor to these pages and, in my opinion, one of the brightest young minds in the investment management space, Ben Davies talks to "The Dusseldorfer" (who is NOT a character from a Tarantino movie) about financial repression, the dire state Europe finds itself in and the problems with technocratic governments.

As always, Ben's insight is clear and compelling and his ability to communicate complex ideas is second to none.

With apologies to all of you who waded through my tortured prose at the beginning of this week's edition of Things That Make You Go Hmmm....., here is Jim Grant discussing many of the same points - just in far more erudite fashion. Had this been posted a day earlier, it may have saved ALL of us a lot of work...

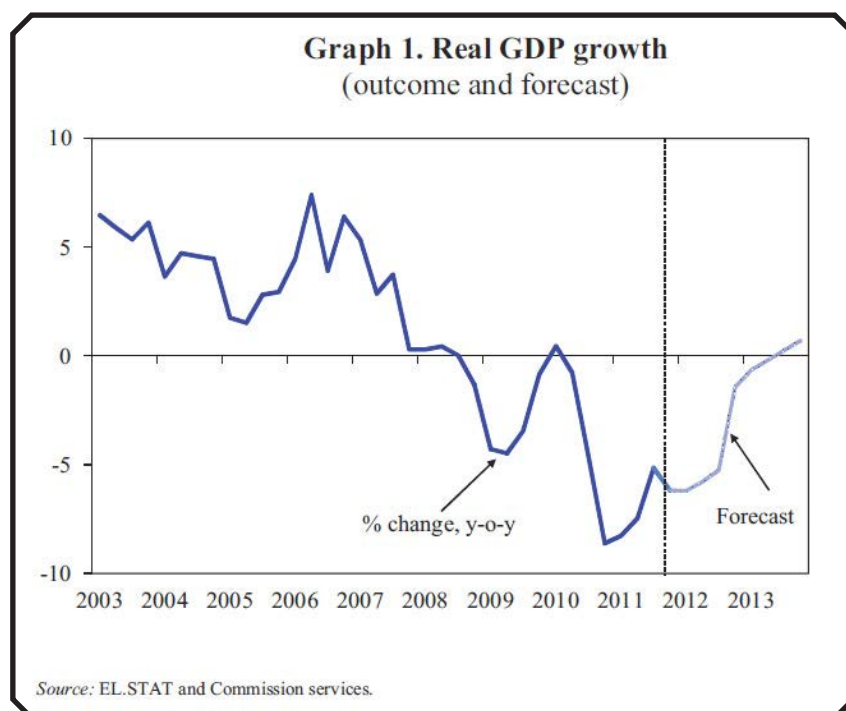


[CLICK TO WATCH](#)

and finally...

Courtesy of my friends at Zerohedge comes this piece of comedic genius which is possibly the most amusing 'And Finally....' I have ever included:

Reuters has been kind enough to release the "Second Economic Adjustment Programme for Greece" - a 195 page blueprint that Greece has to follow (unlike the first one, which it kinda, sorta ignored) in order for the money to keep flowing (money to bail out Europe's banks that is). We can save you the reading: below is the only chart of note. This is what the European powers expect Greek GDP to do. It needs no further commentary.



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[SOURCE: EL.STAT \(VIA ZEROHEDGE\)](#)

Hmmm...

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Grant Williams

Grant Williams is a portfolio and strategy advisor to Vulpes Investment Management in Singapore - a hedge fund running \$200million of largely partners' capital across multiple strategies.

In 2012, all Vulpes funds will be opened to outside investors.

Grant has 26 years of experience in finance on the Asian, Australian, European and US markets and has held senior positions at several international investment houses.

Grant has been writing 'Things That Make You Go Hmmm.....' for the last three years.

For more information on Vulpes Investment Management please visit:

www.vulpesinvest.com



As a result of my role at Vulpes Investment Management, it falls upon me to disclose that, from time-to-time, the views I express and/or the commentary I write in the pages of *Things That Make You Go Hmmm.....* may reflect the positioning of one or all of the Vulpes funds - though I will not be making any specific recommendations in this publication.

Grant

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