THINGS THAT MAKE YOU GO Hmmm...

A walk around the fringes of finance

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“What you see is what you get
You’ve made your bed, you better lie in it
You choose your leaders and place your trust
As their lies put you down and their promises bust
You’ll see kidney machine replaced by rockets and guns
And the public wants what the public gets”

– THE JAM, *GOING UNDERGROUND*

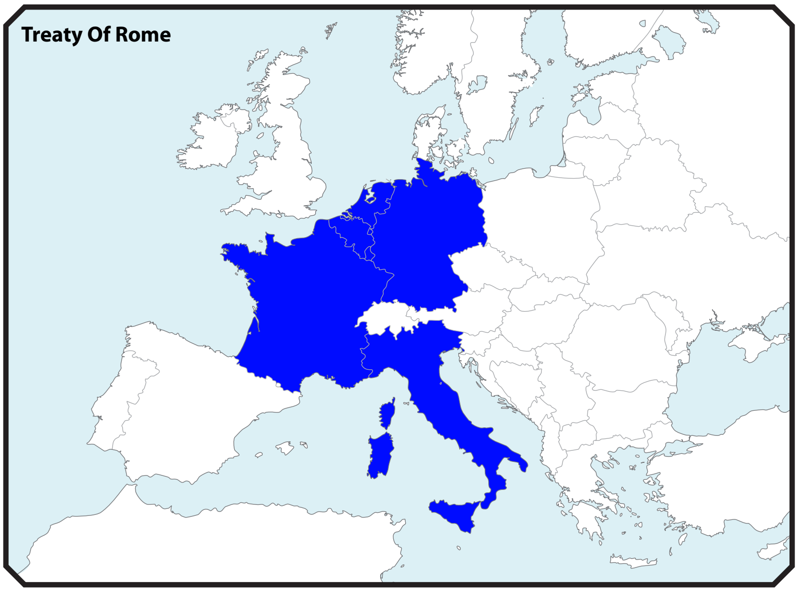
“While other countries struggle to command confidence in their fiscal forecasts we have created an internationally admired and respected independent office for budget responsibility. These bold steps have made Britain that safe haven in the sovereign debt storm...”

– George Osborne, *UK Chancellor of the Exchequer, August 11, 2011*

“And until you’ve repaid
The dreams you bought for your lies
You’ll be cast away
Alone under the stormy skies

But I hope you know
That it won’t let go
It sticks around with you until the day you die”

– Oasis, *Where Did It All Go Wrong?*



On March 25, 1957 in Rome, two representatives each from West Germany, Italy, the Netherlands, Belgium and Luxembourg sat around a large, fancy table, took out their large, fancy fountain pens and signed a rather large and fancy document that was rather grandly known as The Treaty of Rome. At a stroke the European Economic Community (or 'Common Market') was established (along with the European Atomic Energy Commission - those Europeans do LOVE a commission), the purpose of which was to gradually eliminate trade barriers between member nations and introduce common policies for agriculture, transportation and economic relations between both the member states and those outside the Treaty.

In 2007, on the 50th anniversary of the signing of the treaty, one of the lawyers responsible for its drafting, Pierre Pescatore, told the BBC that all was not as it seemed that day:

> *"They signed a bundle of blank pages...The first title existed in four languages and also the protocol at the end; nobody looked at what was in between."*

A fitting start for what would eventually morph into the European Union as we know it today. The reason for the hastiness in getting an 8-inch high stack of papers signed by the dignitaries present? Fears that General de Gaulle could soon return to the French presidency and block the treaty.

And so it began.

But the origins of the Treaty of Rome were founded in the Treaty of Paris which created the European Coal and Steel Community (ECSC) 6 years earlier, in April 1951, in an attempt to bind together a continent rent asunder by the horror of WWII. The architects of this political construct were a pair of Frenchmen, Robert Schuman (the French Foreign Minister) and Jean Monnet (a civil Servant), and their idea was to tie together the coal and steel industries of France and Germany under a High Authority that would allow other European countries to join should they wish to do so, thus reuniting the war-torn countries of Europe and forever banishing the chances of another conflict between them. Italy and the Benelux countries joined the negotiations and, on April 18 1951, the Treaty was signed.

The intervening 6 years between the signing of the Treaty of Paris and that of Rome, were a sign of what was to come in Europe as Commission after Commission, several Assemblies, a couple of Communities and a bunch of Committees were formed and countless Reports written to be presented at numerous Conferences in an attempt to further the idea of a united and peaceful Europe. This passage does a very nice job in outlining just how bureaucratic Europe was, even in its nascence:

> *(Wikipedia): The Spaak Report drawn up by the Spaak Committee provided the basis for further progress and was accepted at the Venice Conference where the decision was taken to organise an Intergovernmental Conference. The report formed the cornerstone of the Intergovernmental Conference on the Common Market and Euratom at Val Duchesse in 1956.*
>
> *The outcome of the conference was that*

new communities would share the Common Assembly (now Parliamentary Assembly) with the ECSC, as it would with the Court of Justice. However they would not share the ECSC's Council of High Authority. The two new High Authorities would be called Commissions, this was due to a reduction in their powers. France was reluctant to agree to more supranational powers, and so the new Commissions would have only basic powers and important decisions would have to be approved by the Council

Colour me cynical if you must, but surely anybody reading this paragraph in 1955, would have had a fairly good idea which direction this project was headed?

But I digress.

The Treaty of Rome would form the foundation for what would later become the EU that we know and love 50+ years on in all its bureaucratic glory and amongst those original signatories - as well as those that abstained - are the clues as to just how important a part the idea of 'Europe' was and is to various countries.

"... What is to be done? Our answer is that we must anchor the agreements we have made more firmly and take tougher action to enforce them..."

Case in point: the Netherlands and the United Kingdom.

The Dutch were signatories to the Treaties of Paris and Rome and to every major European Treaty since and are staunch supporters of a unified Europe as well as having a reputation for being amongst the more fiscally disciplined members of the EU. When Greece and, latterly, Spain prove to be a little recalcitrant when it comes to balancing the cheque book, Europeans shrug and express dissatisfaction but little surprise. When the Dutch announce they will be a little short in meeting their fiscal targets, you can bet your bottom euro that eyebrows will be raised.

A mere six months ago, in September of 2011, Dutch Prime Minister Mark Rutte and his Finance Minister, the delightfully-named Jan Kees de Jager, penned an opinion piece in the Financial Times that was entitled 'Expulsion From The Eurozone Has To Be The Final Penalty' in which they laid out their views on fiscal profligacy amongst the more prodigal (Southern) states in the union. Right from the outset, Rutte and de Jager were in no mood to take prisoners:

(FT): The eurozone is in stormy waters. The turmoil on the financial markets shows no sign of abating. Tackling the debt crisis is complex and calls for several immediate measures. But amid our hectic day-to-day efforts to fight the crisis, we need to ask how we can guarantee a stable euro and prosperous Europe in the long term.

What is to be done? Our answer is that we must anchor the agreements we have made more firmly and take tougher action to enforce them.

Tough talk indeed from two hitherto bit-part actor in the Merkozy/Shaueble/Juncker Show.

Clearly warming to the sudden glare of the spotlight, Rutte and de Jager took off their jackets, loosened their ties and rolled up their sleeves:

...[b]ut the main cause of the current problems is that some countries played fast and loose with the very rules designed to guarantee budgetary discipline. Other countries allowed that to happen, and this took place at a time when the financial markets were being rapidly integrated. The result is that acute financial problems can spread from one country to another at lightning speed.

So what is to be done now? We must return to the anchors of the eurozone. The rules are still valid, but all participants must abide by them. If the eurozone is to survive in its present form as a stable currency union that supports the internal market and our prosperity, there needs to be radical break with the past.

Ah yes, but it's all very well proposing a 'return to the anchors of the eurozone', but practically-speaking, what does that entail, we wondered?

Well, we weren't left wondering for long:

> *What we propose is twofold, and builds on the ideas already put forward by the French and German leaders. First, we call for independent supervision of compliance with the budgetary rules. Second, we believe that countries that systematically infringe the rules must gradually face tougher sanctions and be allowed less freedom in their budgetary policy.*

"... Whoever wants to be part of the eurozone must adhere to the agreements and cannot systematically ignore the rules. In the future, the ultimate sanction can be to force countries to leave the euro...."

> *Independent supervision requires a commissioner for budgetary discipline. His or her powers should be at least comparable to those of the competition commissioner. The new commissioner should be given clear powers to set requirements for the budgetary policy of countries that run excessive deficits. The first step is to require the country concerned to make adjustments to its public finances.*

> *If the results are insufficient, the commissioner can force a country to take measures to put its finances in order, for example by raising additional tax revenue. At this stage sanctions can also be imposed, such as reduced payments from the European Union Cohesion and Structural Funds, or higher contributions to the EU budget. The final stage will involve preventive supervision, and the budget will have to be approved by the commissioner before it can be presented to parliament. At this stage, the member state's voting rights can also be suspended.*

> *Countries that do not want to submit to this regime can choose to leave the eurozone. Whoever wants to be part of the eurozone must adhere to the agreements and cannot systematically ignore the rules. In the future, the ultimate sanction can be to force countries to leave the euro.*

Bravo! Finally, amidst the back and forth and contradictory statements of the main players on the EU stage, some clear, concise and sensible steps proposed by one of Europe's mainstays.

But September was a LONG time ago and a matter of days after Spain's unilateral decision to abide by its own budget deficit target of 5.8% as opposed to the mandated 4.4% was announced (and a compromise quickly reached by EU finance ministers who took Senor Rajoy at his word that the 2013 target of 3% would still be met.....<blink>), rumblings began about the likelihood of the Dutch taking on the role of (unlikely) Euro Bad Boys:

> *(The Economist): It was a far cry from the bright autumn day in 2010 when the smiling leaders of the three right-of-centre Dutch parties came together to announce a deal to run the country. The Liberals, the largest party, would form a minority coalition with the Christian Democrats. Outside support from Geert Wilders's Freedom Party would give the government a slim majority in parliament. This year, on a foggy March morning, the same three leaders looked sombre in the face of a daunting task: how to cut another €9 billion ($12 billion) from the budget for 2013 when the economy is already in recession.*

> *The extra cuts are needed to deal with what forecasters say would otherwise be a 2013 budget deficit of 4.5% of GDP, way over the 3% limit enshrined in the euro zone's new fiscal pact. Yet Mr Wilders is likely to object. Indeed, he is in an objecting mood: this week he presented a report commissioned from British researchers making the case for Dutch withdrawal from the euro. Mr Wilders, who wants a referendum on the matter, claims that the country has not profited and may even have lost from its membership of the single currency.*

Ten days after The Economist published that article, the Dutch officially jumped the shark:

> *(UK Daily Telegraph): Just a few weeks ago officials from Madrid begged in Brussels for their fiscal targets to be relaxed - they said the current ones were "suicidal" for Spain. Jan Kees de Jager, the Dutch finance minister, was among them who demanded the answer to be "neit".*
>
> *So now - fiesta, forever, all night long - today the Netherlands Bureau for Economic Policy Analysis (CPB) said the country's budget deficit could increase to 4.6pc of GDP during 2013 and 2014. The level drives a coach and horses through the fiscal pact which is less than three weeks old.*

That fiscal pact - hailed as a breakthrough in the fight to stabilize the splintering Eurozone - had been signed by just 25 of its 27 members as both the Czech Republic and the United Kingdom broke ranks and refused to add their John Hancocks to the joint handcuffs.

"... Further, February's £12.909 billion in the UK government's borrowing represents a disturbing +112.8% increase compared to the February 2011 borrowing of £6.066 billion

Now, apart from the fact that it represents a very respectable scrabble score, I will readily admit that my knowledge of all things Czech is somewhat sketchier than that of the land in which I was born and besides, I dare say that even if I were to spend hours czeching up on the fiscal dynamics of that particular country, I would not find anything remotely as curious as the current confusion surrounding Britain's 'austerity drive' - the response to which, as a colleague sagely pointed out this week is akin to an extremely heavy drinker ordering 12 tequila shots and being universally praised for promising to go on the wagon tomorrow.

Britain's 'austerity drive'

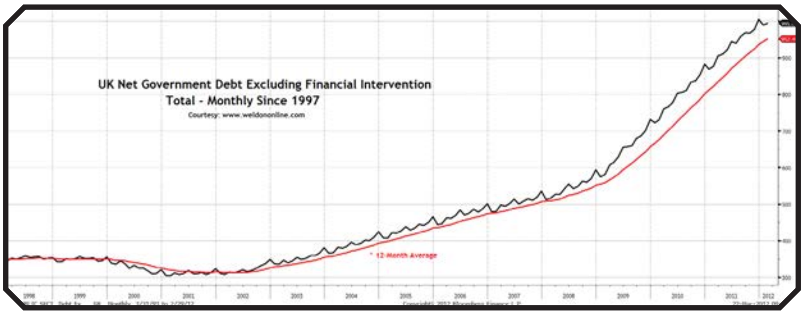
really has been nothing of the sort when you look at the numbers (which we shall do in a moment), but somehow, in a brilliant piece of marketing, the coalition government have managed to talk tough whilst simultaneously bringing the UK's Public Sector Borrowing Requirement (PSBR) to a little over 60% ABOVE where it was when they took office in May 2010.

In his most recent piece of surgical brilliance, Greg Weldon (www.weldononline.com) laid out the numbers in simple fashion, revealing just how bad things have become in the Sceptered Isle:

> *February's £12.909 billion in Net Borrowing represents the thirteenth largest single-month borrowing by the UK government since the Treasury was founded four centuries ago ... and, also represents ... the LARGEST EVER Public Borrowing for the month of February.*
>
> *Further, February's £12.909 billion in the UK government's borrowing represents a disturbing +112.8% increase compared to the February 2011 borrowing of £6.066 billion. Indeed, note the horrifying sequential rise in UK government borrowing during the month of February, dating back to 2001, when the government was actually 'paying down' debt (monthly Net Public Borrowing, all figures in £, a negative number indicates a 'net retiring' of government debt):*
>
> *Feb-2012 ... 12.909 billion*
> *Feb-2011 ... 6.066 billion*
> *Feb-2010 ... 7.955 billion*
> *Feb-2009 ... 7.178 billion*
> *Feb-2008 ... 0.833 billion*
> *Feb-2007 ... (-) 0.015 billion*
> *Feb-2006 ... 1.486 billion*
> *Feb-2005 ... 2.034 billion*
> *Feb-2004 ... (-) 1.445 billion*
> *Feb-2003 ... 0.272 billion*
> *Feb-2002 ... (-) 1.565 billion*
> *Feb-2001 ... (-) 3.296 billion*

Greg continued with a look at the UK government's debt outstanding NOT including the expansion in the BoE's balance sheet and points out the following chilling statistic:

> *We observe the growth in UK Government Debt Outstanding, NOT including the expansion in the Bank of England's Balance Sheet and official 'financial intervention' ... revealing the upside acceleration in 2009, and February's figure, which at 955 billion GBP*



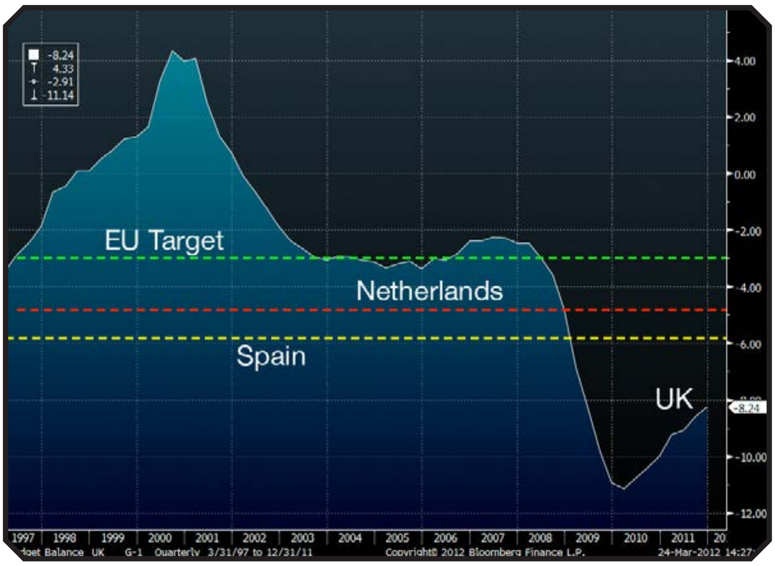
SOURCE: GREG WELDON

> *is the second highest EVER recorded, and is +13.5% higher than the year-ago February total of 877.3 billion.*
>
> *In just four short years, since February of 2007, UK government debt has nearly DOUBLED, rising by +98.8% !!!! (chart below)*

Certainly *not* the kind of austerity demanded by Frau Merkel und freunde.

Britain's budget deficit

currently stands at 8.24% of GDP (admittedly,



SOURCE: BLOOMBERG

an improvement upon the 11.14% it reached in 2010) so even if David Cameron HAD acquiesced to the pleas from the rest of Europe to join the fiscal compact, it is abundantly clear that there is absolutely zero chance that he would have been able to comply with its terms. In fact, by comparison, Spain and the Netherlands look positively austere (chart, bottom left).

But it is in amongst the weeds of the UK's budget projections that the full horror of Britain's fiscal situation presents itself.

Having wildly optimistic estimates that don't go anywhere near standing up to any kind of real-world scrutiny is nothing new these days - one only has to look at the forecast curves for the US deficit of the US Congressional Budget Office to witness an exercise in the triumph of hope over experience, but the UK's own 'austerity' program - so loudly praised by those responsible for selling it - appears to be almost devoid of cuts altogether. In assembling any such projection, those responsible are fortunate to have two sides of the ledger to play with and, if everybody is focusing on the level of spending cuts required, it is often safe to assume that nobody is looking at the revenue projections and so that is where one can find the more ... 'optimistic' numbers. That fact has been curiously missed by many commentators who have fallen for the siren song of the coalition, amongst them Bloomberg's very own Clive Crook:

> *To help restore financial confidence, the government would tighten fiscal policy at once. The idea was that austerity, done correctly, would promote growth. It would remove the threat of fiscal collapse. With public borrowing in check and confidence improved, the private sector would take up the slack.*
>
> *It didn't happen. Britain's households aren't spending, and its businesses, despite running big financial surpluses, aren't investing. For the past 18 months output has been essentially flat, still well below its level when the recession began. Official forecasters*

think output won't regain its 2008 level until 2014 -- a slower pace of recovery than Britain experienced after the Great Depression.

In one way, the figures flatter the Tories' fiscal experiment, because the Bank of England has been more forceful than the Federal Reserve in supporting the economy with quantitative easing (where the central bank buys debt to increase the money supply). The Bank of England persisted in this approach despite high inflation, which peaked at more than 5 percent last year, against the Bank's official target of 2 percent. Without such aggressive loosening of monetary policy, the economy would be in even worse trouble.

"...In order to 'support' a sizable EXPANSION in SPENDING over the next five years (pegged at +12.7%), the UK Treasury is RELYING on an astronomical rise in Revenue over that same five year period, pegged at +33.4%"

Together, though, monetary and fiscal policy are still doing too little to support demand. Inflation has fallen in recent months and, according to the Bank, is on track to drop below the 2 percent target. Some of last year's inflation surge was due to an increase in value added tax, which will drop out of the numbers. Expectations of inflation have stayed well under control -- a tribute to the Bank's ability to explain itself -- and, crucially, with unemployment still very high, there's no sign of wage inflation.

The Bank can do more QE if need be, but looser fiscal policy can and should be part of the mix. Unfortunately, the government is unlikely to admit its mistake and concede that fiscal policy has been too tight...

A looser fiscal policy than the one that has seen borrowing surge since it was implemented and that contains spending INCREASES in each of the next 5 years may NOT be such a good idea if looking for austerity, but to reveal the full horror of the UK government's basis for their projections, we return to Greg Weldon, who has by no means been fooled for one second (these next paragraphs are definitely NOT for the fiscally faint of heart):

Not only are there NO spending cuts within the UK Budget projections for the next five years, annually through the year 2017 ...

... UK government spending will increase, every year, including an expansion of +2.8% scheduled to be implemented this year.

The UK government is 'banking on' growth in Revenue that will exceed the rate of growth in Expenditures, including growth of +3.5% cooked-into-the-books for this year.

But, the margin for error is slim, with year-over-year Revenue forecast to grow by more than the growth in year-over-year Spending, by a mere £1.4 billion.

Over the next five years things get even more interesting.

In order to 'support' a sizable EXPANSION in SPENDING over the next five years (pegged at +12.7%), the UK Treasury is RELYING on an astronomical rise in Revenue over that same five year period, pegged at +33.4%.

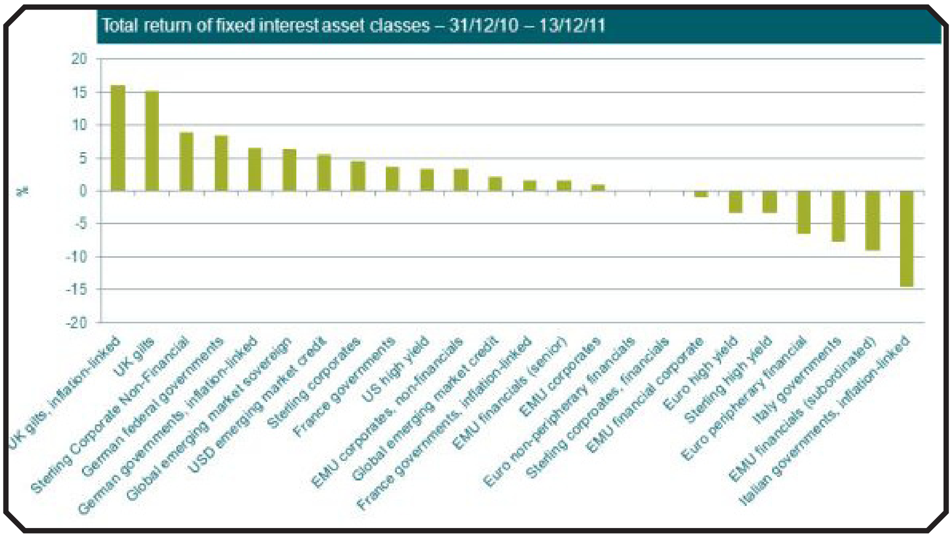
Revenue is forecast to rise by +£184.2 billion over the next five years, or by nearly +£40 billion per year.

Ahem, excuse me ... perhaps the UK Treasury overlooked the FACT that Revenue in February, pegged at £38.631 billion was (-) 1.9% BELOW the year-ago February revenue of £39.381 billion.

A decline of nearly £1 billion is FAR from the projections calling for a near +£40 billion per year increase over the next five years.

(There is much, much more in Greg's report - as there always is - and if you HAVEN'T already signed up for a free trial of his work then do yourselves a HUGE favour and click HERE)

Along with these fanciful estimates, the UK is also relying on a projected fall in the savings rate from 6.6% to 5.0% over the next 4 years to



CLICK TO ENLARGE

SOURCE: BAML/M&G

help it reach its targets - and all this in a country with inflation running at a little under double the targeted 2% rate (though admittedly trending in the right direction at last after reaching 5.5% in September of 2011).

But as incredible as all this sounds, perhaps the most oddly-shaped piece of this particular puzzle is the UK government bond market - or, as they are known colloquially, 'gilts'.

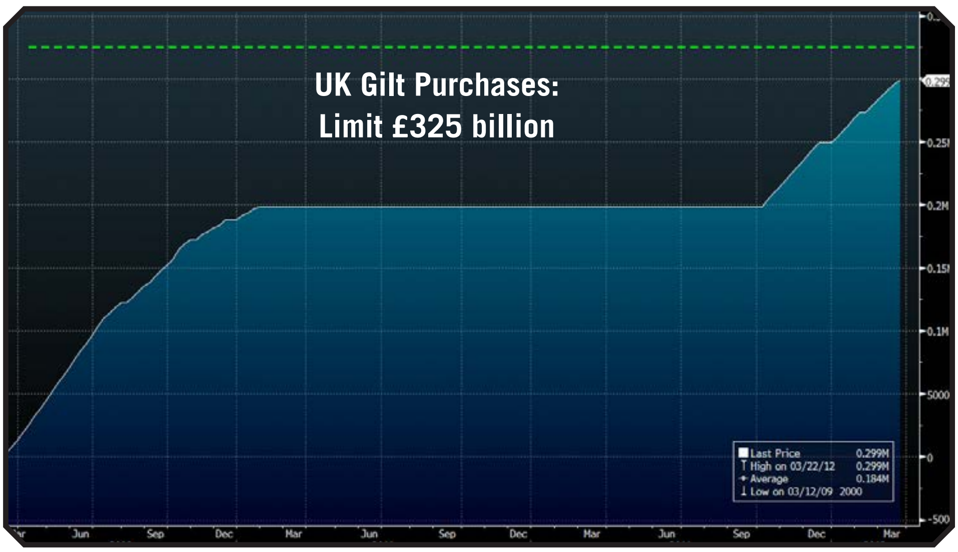
Currently, the only thing remotely 'gilt-edged' about UK government bonds is the fact that they have a AAA rating from the geniuses at Moody's and S&P - but that has, in recent years, become akin to having your accounts approved by Sino Forest's audit team and so it's hard to justify the fact that UK Gilts become the world's best-performing asset class in 2011 (chart, left).

A lot of this performance has been down to Britain's willingness to be the most eager of Quantitative Easers over the last several years and the £300billion in gilts that have been bought by the Bank of England since March of 2009 have gone a long way towards establishing perhaps the most curious of government bond markets anywhere in the world (with the possible exception of Japan).

Currently, the BoE has a further £25 billion of gilt purchases approved under the QE program and until the end of June to make those purchases (chart, below left). What happens after June is anybody's guess, but, should further easing not be forthcoming, it is hard to see how UK bond yields do anything but go higher - potentially a LOT higher based on the underlying state of her finances.

The popularity of Liability Matching amongst UK pension funds has all but guaranteed a disastrous outcome for a generation of 'savers' as rates have been held artificially low in a highly inflationary environment but perhaps the biggest 'tell' that the status quo cannot possibly go on for much longer came last week when George Osborne tabled an idea not used since the aftermath of WWI - 100-year gilts:

(UK Daily Telegraph): Britain is to offer 100-year gilts, meaning current Government borrowing will not be repaid until the next century, ...



SOURCE: BLOOMBERG

The Chancellor hopes that the 100-year gilts will help to "lock in" the benefits of Britain's international "safe haven" status. The interest rates paid by the Government to borrow money have recently fallen to a record low and it is hoped the new gilts will mean "our great-grandchildren" can benefit from the low rates.

Currently, the average duration of the Government's £1 trillion debt is around 14 years – with maturities ranging from months to a 50-year bond issued in 2005. Longer-dated debt is widely thought to offer a country more stability.

A Treasury source said tonight: "This is about locking in for the future the tangible benefits of the safe haven status we have today. The prize is lower debt interest repayments for decades to come.

"It is a chance for our great-grandchildren to pay less than they otherwise would have done because of the government's fiscal credibility."

Wow!

"…..from the investors' point of view it makes no sense whatsoever and if it ever comes to pass, I can guarantee it will eventually be seen as one of the most colossal cases of mis-selling ever seen in the UK – and there have been quite a few.

Firstly, Britain's 'safe-haven status' is a fallacy. It is no more safe than many of the other major economies who are choking on debts that cannot be paid off. The only reason it HAS that status currently is because of the very Achilles Heel that will ultimately prove to be its demise - the ability to print its own currency. By NOT being a part of the euro experiment, Britain has kept control of its fate and has been able to print its way out of trouble - so far - while its neighbours to the east have all been lashed to the deck of the same sinking boat, but the day is coming when Britain's profligacy will become important again. As I keep saying; none of this matters to anyone until it matters to everyone.

Secondly, interest rates may have 'fallen to a record low' but they have done so in the same way heavily-indebted gamblers often 'fall' from hotel rooms - with a big push (only this time from the Bank of England and not a guy called Fat Tony). Like US Treasurys, the price of UK gilts would be nowhere near these levels without a captive and very friendly buyer in the shape of the central bank.

And then there's the 'treasury source' who spoke of '*locking in for the future the tangible benefits of the safe haven status we have today'* before finishing with a flourish when he tugged at the heartstrings of investors by referring to great-grandchildren who would be paying less in interest repayments than they otherwise would have done because of (and I'm going to give this last comment the space it deserves;

"...the government's fiscal credibility"

I have yet to find anything remotely credible about the UK governments fiscal policy - it's marketing policy, yes, but fiscal policy? Not so much.

Clearly, any government looking to lock in rates for 100 years is supremely confident of two things:

1: Rates are as low as they are going to be for 100 years

2: They have suckers at the table willing to lock those rates in for that length of time.

But a funny thing happened on the way to locking in for the future the tangible benefits of the safe haven status Britain enjoys today - the once-in-a-lifetime offer received withering criticism:

(Jeremy Warner): ...from the investors' point of view it makes no sense whatsoever and if it ever comes to pass, I can guarantee it will eventually be seen as one of the most colossal cases of mis-selling ever seen in the UK – and there have been quite a few.

As any student of economic history knows, periods of very low interest rates can last an awfully long time, but they have never lasted 100 years or anywhere close. Any such gilt is therefore a hostage to long term fluctuations in interest rates and inflation. One thing is absolutely guaranteed – inflation adjusted, £1,000 invested in a 100-year bond today, even with interest re-invested, won't be worth anywhere close at maturity.

"...£1,000 invested in the War Loan back then would in today's money be worth less than £20."

Anyone who invests is therefore more or less agreeing to a long term loss, or to a net transfer of part of his wealth to the Government

Warner went on to examine how the last buyers of 100-year gilts made out:

From the Government's point of view it was a masterstroke which transformed the public finances, but it was a disaster for investors. The new stock immediately plunged in value, yet the real damage was to come later from the value destructive effects of inflation. £1,000 invested in the War Loan back then would in today's money be worth less than £20.

The National Association of Pension Fund Managers were similarly scathing:

(FT): The National Association of Pension Funds on Wednesday criticised the chancellor's plans for an "Osborne bond" – a 100-year debt issue or even a perpetual gilt that never matures – saying it would prefer shorter maturity debt that was protected against inflation.

One senior UK fund manager said: "This could be of interest for pension funds as it would be a good match for their liabilities." But another said: "We would not be buyers of this debt because the yields are too low. It would be great for the government and the British taxpayer, but I don't think we would want to lock in yields so low for such a long time. Yields are artificially low because of the Bank of England's quantitative easing initiative."

And it is in this reaction that the writing on the wall for government bonds becomes clearer still.

We have reached the point where investors are comfortable enough that the fear of a systemic collapse has now more or less dissipated and faith in a resumption of growth (at least in the US) is slowly returning (though I have my doubts about that being the case but more of that another day). It was precisely this fear that drove them into government bonds in the first place but now that they have started to care once again about such trivial matters as price and yield, there is only one price-insensitive buyer left in the game - and that buyer (at least in the UK) only has £25 billion in his pocket. Sounds like a lot of money, huh? It used to be.

And so, Greece and Spain fail to reach the limits imposed by the fiscal compact, now it's Holland's turn and the UK couldn't get near it even if it WERE a signatory.. Portugal is sinking rapidly into the swamp and this week Ireland, poster child for austerity, has announced that it has slipped back into recession.

Anybody out there think we have heard the last of this whole 'Europe thing'?

Me either.

Of course, if Europe WERE to completely collapse, just think how low yields of government bonds would be...

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OK... so after a LONG introduction this week, I'm all out of space and, rather than give you ANOTHER page to wade through, I'm going to just leave you to dive right into the main course and bid you a fond farewell until next time.

As they say in the UK:

Toodle-oo

Contents

25 March 2012

The Gonnie, Gonnie Banks

#	Bank	Assets ($m)	Deposits ($m)	Cost ($m)
14	Covenant Bank & Trust, Rock Spring, GA	95.7	90.6	31.5
141	Premier Bank, Wilmette, IL	268.7	199.0	64.1
	Total Cost to FDIC Deposit Insurance Fund			**95.6**

Water wars could be a real prospect in coming years as states struggle with the effects of climate change, growing demand for water and declining resources, the secretary of state for energy and climate change warned on Thursday.

Ed Davey told a conference of high-ranking politicians and diplomats from around the world that although water had not been a direct cause of wars in the past, growing pressure on the resource if climate change is allowed to take hold, together with the pressure on food and other resources, could lead to new sources of conflict and the worsening of existing conflicts.

"Countries have not tended to go to war over water, but I have a fear for the world that climate instability drives political instability," he said. "The pressure of that makes conflict more likely."

…"Countries have not tended to go to war over water, but I have a fear for the world that climate instability drives political instability," he said. "The pressure of that makes conflict more likely."

Even a small temperature rise – far less than the 4C that scientists predict will result from a continuation of business as usual – could lead to lower agricultural yields, he warned, at a time when population growth means that demand for food was likely to be up by 70% by 2060. By the same time, he noted, the number of people living in conditions of serious water stress would have reached 1.8 billion, according to estimates.

"Climate change intensifies pressures on states, and between states," he told the conference, gathered to discuss whether climate change and natural resources should be regarded as a national security issue. "[Its effects] can lead to internal unrest … and exacerbate existing tensions. We have to plan for a world where climate change makes difficult problems even worse."

But Davey recalled previous global catastrophes that had been averted, including the threat of nuclear armageddon during the cold war, and successes such as the elimination of smallpox. He urged governments to work on adapting to climate change as a matter of urgency, as well as striving for an international agreement to cut greenhouse gas emissions.

His call was echoed by Ali Bongo Ondimba, president of the Gabonese Republic. He told the conference that Africa was the most vulnerable part of the world to climate change, but that African people had been responding to a changing climate for thousands of years – his own Bantu people had been forced, centuries ago, to move around Africa as areas dried out and food became scarcer.

UK GUARDIAN / **LINK**

Emirates, the biggest airline by international traffic, said more carriers will go bust this year as fuel costs and sluggish economies undermine profitability.

"We can reel off a whole load of airlines that are teetering on the brink or are really gone," Tim Clark, the Dubai-based carrier's president, said in an interview. "Roll this forward to Christmas, another eight or nine months, and we're going to see this industry in serious trouble."

Airline profits will plunge 62 percent in 2012 to $3 billion, equal to a 0.5 percent margin on sales, as oil prices rise, the International Air Transport Association said this week. Emirates's fuel bill accounts for 45 percent of costs and may jump by an "incredibly challenging" $1.7 billion in the year ending March 31, according to Clark, who says he's sticking with a no-hedging strategy rather than risking a losing bet.

"You think you're going to win, but in the long term you always lose," Clark said yesterday at the Gulf carrier's head office near Dubai International Airport. "When we enter into derivatives, betting whatever it may be with counterparties who actually control the price of fuel in the first place, you have to ask yourself, 'Is that smart?'"

American Airlines is restructuring after filing for Chapter 11 bankruptcy and India's Kingfisher Airlines Ltd. may lose its license as it struggles with cash shortages and losses. That's after Barcelona-based Spanair SA collapsed Jan. 27, followed that week by Hungarian national carrier Malev Zrt.

Clark said some private airlines will need to be bailed out by governments in the countries where they're based, though that will raise aid issues with the European Union and other parties.

In the U.S., more filings for Chapter 11 protection are likely, while smaller carriers operating in the Indian Ocean region and in Africa face "difficulties," the executive said.

"This is what the fuel prices are doing," he said. "It's about time somebody sitting there, controlling the fuel prices, began to look a little bit more seriously at the devastation it's causing, not only to airlines but to the global economy."

... "We can reel off a whole load of airlines that are teetering on the brink or are really gone,"

The industry couldn't survive a further 10 or 15 percent increase in fuel prices, especially with the European Union's carbon emissions trading system about to add to costs, he said.

At Emirates the fuel bill, while not over budget, has "zapped the bottom line," and that will be evident in annual results scheduled to be published next month, Clark said.

Earnings at Emirates are also being hurt by the continued grounding of Airbus SAS A380 superjumbos, of which it's the No. 1 operator, after the discovery of wing cracks. Six of the jets, which generate $50,000 an hour 15 hours a day, are out of action for repairs, idling 830 cabin crew and 160 pilots, and the carrier is having to compensate people set on an A380 trip.

"That's had a poleaxing affect in the last nearly three months," Clark said, estimating the revenue loss so far at $90 million. "Those airplanes are always full, they're always popular. We've had multiple cancellations. We've had people telling us 'Well you sold me the A380', so we had to throw in 5,000 or 10,000 miles or give money back. It's a mess."

★ ★ ★ *BLOOMBERG* / **LINK**

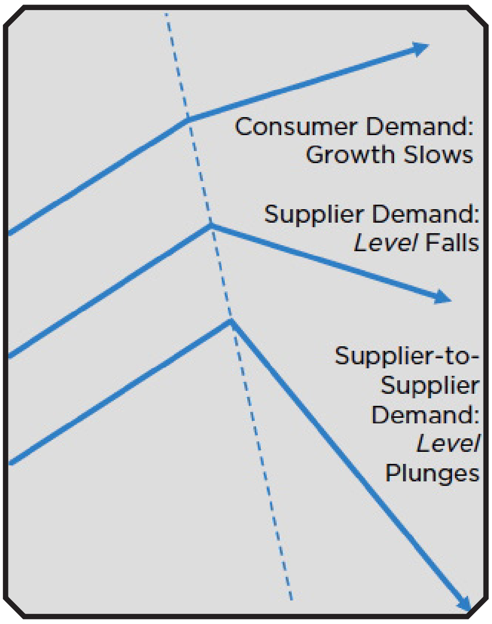
The idea of "decoupling" often comes up as a way for one part of the world to dodge weakness elsewhere. But, over the last two decades, a key driver of the greater coupling of economic cycles had been the increasing interdependence of world economies, with more openness in the flows of capital and trade – especially merchandise trade. Indeed, the export dependence of most economies has risen dramatically in this period. We see that export/GDP ratios have increased sharply since the early 1990s across all countries, which is evidence of the intensification of global integration through trade.

In the Asia-Pacific region, this proportion roughly doubled for Japan, more than tripled for India and Korea, and advanced to roughly 75% from 42% for Taiwan. In China, the share of exports relative to GDP had also doubled by about 2007. Since then, there has been a gradual decrease, with exports still accounting for about a quarter of Chinese GDP. Meanwhile, in the Eurozone, exports as a percentage of GDP have jumped to 44% from 26% in 1995. In the U.K. the proportion increased from 19% in 1990 to 30% at present. In the Americas, the proportion of Canadian exports increased from 25% in the early 1990s to 45% in 2000, before falling back to around 34%. Similarly, Brazilian exports almost doubled as a share of GDP from roughly 7% in early 1991 to around 14% in late 2006, only to fall back and settle at around 12% recently. Meanwhile, Mexican exports have tripled their share of GDP, while the U.S. ratio of exports to GDP has almost doubled from 7% in 1990 to nearly 14% now.

The implications of this increased interdependence based on trade linkages are magnified by the workings of the Bullwhip Effect.

The Bullwhip Effect

- *End user demand is moderately cyclical.*
- *Supplier demand is more cyclical.*
- *Supplier-to-supplier demand,furthest up the supply chain, is most cyclical. But supply is relatively insensitive, so prices become highly cyclical.*



SOURCE: ECRI

We agree with the consensus that developing economies have become a key driver of long-term secular global growth. But, in cyclical terms, developing economies are very much subject to the Bullwhip Effect, where small fluctuations in consumer demand growth get amplified up the supply chain into big swings in demand as we move away from the consumer. So, smaller shifts in end consumer demand growth translate into larger fluctuations in intermediate goods demand, and even bigger ones in input material demand, and especially, raw material prices.

★ ★ ★ *ECRI (VIA MISH)* / **DOWNLOAD PDF**

Jon S. Corzine, MF Global Holding Ltd. chief executive officer, gave "direct instructions" to transfer $200 million from a customer fund account to meet an overdraft in a brokerage account with JPMorgan Chase & Co. (JPM), according to a memo written by congressional investigators.

Edith O'Brien, a treasurer for the firm, said in an e-mail quoted in the memo that the transfer was "Per JC's direct instructions," according to a copy of the memo obtained by Bloomberg News. The e-mail, dated Oct. 28, was sent three days before the company collapsed, the memo says. The memo does not indicate whether that phrase was the full text of the e-mail or an excerpt.

O'Brien's internal e-mail was sent as the New York-based broker found intraday credit lines limited by JPMorgan, the firm's clearing bank as well as one of its custodian banks for segregated customer funds, according to the memo, which was prepared for a March 28 House Financial Services subcommittee hearing on the firm's collapse. O'Brien is scheduled to testify at the hearing after being subpoenaed this week.

"Over the course of that week, MF Global (MFGLQ)'s financial position deteriorated, but the firm represented to its regulators and self-regulatory organizations that its customers' segregated funds were safe," said the memo, written by Financial Services Committee staff and sent to lawmakers.

Steven Goldberg, a spokesman for Corzine, said in a statement that Corzine "never gave any instruction to misuse customer funds and never intended anyone at MF Global to misuse customer funds."

Vinay Mahajan, global treasurer of MF Global Holdings, wrote an e-mail on Oct. 28 that said JPMorgan was "holding up vital business in the U.S. as a result" of the overdrawn account, which had to be "fully funded ASAP," according to the memo.

Barry Zubrow, JPMorgan's chief risk officer, called Corzine to seek assurances that the funds belonged to MF Global and not customers. JPMorgan drafted a letter to be signed by O'Brien to ensure that MF Global was complying with rules requiring customers' collateral to be segregated. The letter was not returned to JPMorgan, the memo said.

The money transferred came from a segregated customer account, according to congressional investigators. Segregated accounts can include customer money and excess company funds.

Corzine, 65, in testimony in front of the House panel in December, said he did not order any improper transfer of customer funds. Corzine also testified that he never intended a misuse of customer funds at MF Global, and that he doesn't know where client funds went.

"I never gave any instruction to misuse customer funds, I never intended anyone at MF Global to misuse customer funds and I don't believe that anything I said could reasonably have been interpreted as an instruction to misuse customer funds," Corzine told lawmakers in December.

BLOOMBERG / **LINK**

Japan is on an unsustainable path of a strong yen and deflation. The unprofitability of Japan's major exporters and emerging trade deficits suggest that the end of this path is in sight. The transition from a strong to weak yen will likely be abrupt, involving a sudden and big devaluation of 30 to 40 percent. It will be a big shock to Japan's neighbors and its distant competitors like Germany. The yen's devaluation in 1996 was a main factor in triggering the Asian Financial Crisis. Japan's neighbors must have a strong banking system to withstand a bigger devaluation of the yen.

Japan's nominal GDP contracted 8 percent in the four years to the third quarter of 2011, and six percentage points of that was due to deflation. Without increased government expenditure, the contraction will be one percentage point more. Japan has not seen this kind of sustained deflation since the 1930s.

Without government deficits, Japan's economy will decline much more. Central government bonds and borrowings plus its guaranteed debts rose by 116.3 trillion yen during the period, equivalent to one-fourth of the level of the nominal GDP in the third quarter of 2011. If Japan had adopted balanced budgets, its economy would have contracted two to three times more. This will lead to a debt crisis in its private sector.

A strong yen, deflation and rising government debt form a short-term equilibrium that lasts as long as the market believes it is sustainable. The yen has seen a relentless upward trend since it depegged from the dollar in 1971, up to 83.4 from 360 again to the dollar. When wages and asset prices rise, a strong currency can be justified. When wages and asset prices fall, a strong currency is suicide. Japan's nominal GDP peaked in 1997 and its nominal wages did too. Its property prices have declined every year since. The Nikkei rose in only four out of the last fifteen years and is still close to a three-decade low.

Japanese policymakers, businesses, academics, currency traders and the average Mrs. Watanabe all believe in a strong yen. This belief is wrong but self-fulfilling. It has lasted so long because the Japanese government adopts policies to offset the destabilizing effects of deflation due to a strong yen. Hence, Japan's national debt has marched upwards along with the value of yen. It is expected to top yen 1,000 trillion in 2012, 215 percent of GDP, 7.8 million yen (or roughly US$ 94,000) per person, and about half of net household wealth per capita.

The sustainability of Japan's deflationary path depends on the market's confidence in Japan's debt market. As Japanese institutions and households hold almost all of the government's debts, their faith in the government's creditworthiness is the mojo for Japan's seemingly harmless deflationary spiral.

ANDY XIE / **LINK**

"Europe Short of Magic Wands"

That was the headline in the European version of the Wall Street Journal. The front-page headline was "Data Suggest More Woes In Euro Zone." The Purchasing Managers' Index was down, against expectations.

"At a minimum, some analysts said, the recessionary signals make it appear that ECB officials were overly optimistic in recent statements that the euro bloc is on track for recovery and the central bank can start discussing ways to unwind its crisis measure. 'The euro zone is far from out of the woods' said Howard Archer of HIS Global Insight." (WSJ)

That is hardly a surprise. Italy is projected to contract at 1.3% this year. Spain is in recession. Germany and France are barely growing. Spanish interest rates are rising in spite of ECB action, with Spanish rates now above those of Italy.

Spain has been a major topic of discussion here in Stockholm. The conference I spoke at was attended mostly by large asset managers, both fixed-income and equities. Some rather savvy managers were openly wondering how Spain could solve its current woes.

"... How can Spain enter into anything approaching a Greek-like austerity program? Its private sector debt is over 200% of GDP, and they are being forced to deleverage"

The country is in recession. Unemployment is 20% and 50% among youth. The deficit is now projected to be 5.8%, up from the target the previous government agreed to. The EU is not happy with the new Spanish government, which signed the new fiscal agreements only to turn around in a few days and increase its projected deficits.

How can Spain enter into anything approaching a Greek-like austerity program? Its private sector debt is over 200% of GDP, and they are being forced to deleverage. If the public sector attempts to do so, it will make GDP much worse in the short term, which will increase unemployment. Spanish Prime Minister Mariano Rojay is in a no-win situation. (http://en.wikipedia.org/wiki/Mariano_Rajoy) If he cuts the deficit too much, he risks a deeper recession and a corresponding decrease in tax revenues (and rising unemployment costs), which of course makes the deficit worse. For an example, look to Greece to see how well such policies work.

But if he tells the EU to forget their deficit targets, he risks not merely their ire, which he can deal with, but the possibility that they demand a more austere budget in return for assistance.

One of my hosts suggested that Rajoy is in control and can do what he wants. I disagreed, noting that he is in a serious game of poker. He only has access to the bond market at rates that are even close to being sustainable as long as the ECB is buying Spanish debt and funding Spanish banks, which are buying Spanish debt with complete abandon. Spanish banks raised their holdings of Spanish government debt by more than 10% in both December and January, a larger increase than for any other banks in the various nations of the eurozone. There is no reason to think that trend did not continue in February and this month.

Rajoy has pushed all of his chips toward the middle of the table in a gamble that the rest of the euro zone, and most notably Germany, will not really try and force Spain to take serious deficit reduction measures too quickly. "How can they force them?" I was asked.

"Very simply. They simply tell the ECB not to fund Spanish debt below a certain level of interest rates. Indeed, the recent interest-rate rise, well above that of similarly beleaguered Italy, may be more than a coincidence. It may be a less than subtle reminder to Rajoy as to who is in real control. Without ECB help, Spanish bond rates start to look like Greece's, and the end quickly approaches. The only options at that point are default and/or leaving the euro zone."

JOHN MAULDIN / **LINK**

The vehicle Juan Perez calls his Audi is a blue two-seater with seats made of imitation leather. The passenger has to do without an airbag and a seatbelt. Indeed, about the only thing it really shares in common with the German car brand are the four rings on the handlebar meant to look like the Audi logo.

"Do you like my Audi?" Perez asks, throwing his weight into the pedals of his bicycle-powered rickshaw. He dreams of owning an A4 with air-conditioning and alloy rims.

Perez has been working for himself for the last year, now that the Cuban government has granted him a license as a small business owner. He earns the equivalent of €300 ($400) a month. The only problem, he says, is that he has to pay taxes now. His stand is at the beginning of Havana's Calle Neptuno, where rickshaws, mopeds, pre-revolutionary vintage taxis and government-owned Ladas battle for every bit of asphalt amid a cacophony of horns. The smell of gasoline hangs in the air.

The "Neptuno" begins at Prado Boulevard, in the heart of the city, and leads to the university in Vedado, a formerly middle-class neighborhood. Its streets are lined with small shops, handicraft businesses, restaurants and self-serve dining establishments.

"...Raul Castro has "approved the biggest expansion of private economic activity that has ever taken place under the communist regime."

But the Neptuno is no ordinary street. It is a laboratory for the experiments that President Raul Castro has prescribed for Cuba's 11 million inhabitants. What happens in this area will demonstrate whether his ambitious project is a success. Castro wants to combine the state-run economy with market-based reforms in the hope of transforming Cuba into a sort of Caribbean Vietnam.

However, Castro is still ruling out political liberalization. Allowing opposition groups would amount to "the legalization of the parties of imperialism," he warned at a Communist Party congress in late January.

So far, Cubans' hopes that they might be allowed to travel abroad have been in vain since the regime has refused to amend its migration laws. Revolutionary veterans are still in charge in a country where the average age in the National Assembly is well over 70. And regime critics continue to be repressed.

In the economic sphere, however, things that were once unthinkable are suddenly possible. To reduce expenses, the government recently laid off 500,000 employees. They are now permitted to open shops and handicraft businesses, sell real estate, cars and home-grown vegetables, or -- as in the case of Perez -- drive their own rickshaws. Within a year, the number of very small businesses has doubled to almost 350,000. Nevertheless, these ventures are still a far cry from being genuine small businesses or even privately owned companies.

Still, when Pope Benedict XVI arrives on the island for a three-day visit next week, he will experience a "different Cuba," writes the Miami-based El Nuevo Herald, the Spanish-language sister newspaper of the Miami Herald and one that harbors no sympathy for the island nation. According to the paper, Raul Castro has "approved the biggest expansion of private economic activity that has ever taken place under the communist regime."

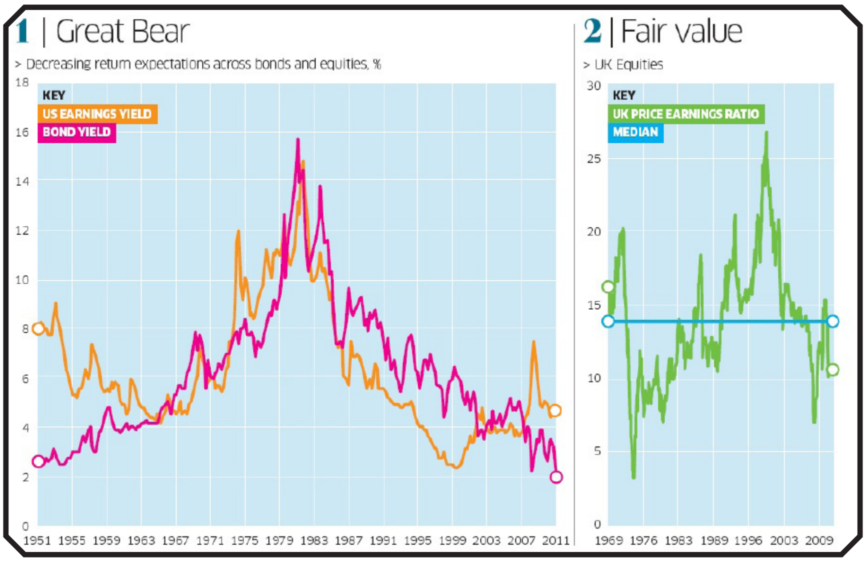
DER SPIEGEL / **LINK**

So the Treasury will in the weeks ahead explore the idea of issuing 100-year and maybe even undated debt. The Chancellor confirmed that in his Budget speech and one of the intriguing things to look for in the coming weeks will be whether there is indeed a market for the stuff or whether the fact that the idea of undated stock should even be floated is a classic sell signal – a sign that the 30-year bull market in fixed interest securities was over.

When I first mooted this possibility a few weeks ago it seemed a "neck-sticking-out" notion. Trying to call a turning point of a 30-year trend is really a bit ridiculous, for the chances of getting the timing of great turning points that occur only once in a generation must be tiny. In any case, the thing that turns long-term interest rates will not be something in the UK: much more likely to be something in the US or even China. But in recent days several things have happened that would seem to support this view: that a huge shift is taking place that will affect us all for years to come.

In the world of British politics George Osborne's latest Budget may be remembered for the ending of the 50p tax rate or the so-called raid on pensioners' incomes – two elements of the Budget that are in economic terms utterly irrelevant. But in the world of global finance it may come to be one of the signals that will mark the beginning of the end of cheap money.

The main graph shows the great bear market in US bonds, followed by the great bull market. Back in the early Fifties 10-year US government



CLICK TO ENLARGE

SOURCE: BARCLAYS CAPITAL

securities carried an interest rate of a little over 2 per cent. They then climbed to reach a peak at the end of the Seventies of 16 per cent, as the red line shows. Then they fell to just 2 per cent at the end of last year. The value of a bond obviously is inverted: the higher the yield the lower the price of any existing stock, and vice-versa.

Since the beginning of this year, however, yields have started to climb: they were around 2.25 per cent on Friday. Much the same pattern applies to UK gilts, and people who spend their lives looking at these things are wondering whether something similar is happening to German bonds. There was a note on Friday from UBS headed: "Bear market for Bunds too?"

If this proves right the three main "safe haven" sovereign debt markets will have all turned some sort of corner. That is not because of any rise in confidence in the eurozone, where the jitters have returned in the past few days. Nor is it the result of any new doubts about German fiscal probity, indeed rather the reverse, for Germany is following through on its plans for a balanced budget by 2016.

★ ★ ★ *UK INDEPENDENT* / **LINK**

Bo Xilai received a hint of a gathering storm that would soon topple him and shake China's ruling Communist party in the form of an oblique warning about the weather.

Bo had flown to Beijing from Chongqing, his city power base in the southwest, for the annual session of the party-run parliament. He was struggling to subdue an uproar after his police chief took refuge in a US consulate for a day.

Telegenic and self-assured in a political elite crowded with wary conformists, Bo was already controversial for thrusting forward "red" Chongqing as a bold alternative model for China.

The astounding antics of his long-time aide, vice-mayor Wang Lijun, threatened to spoil parliament's show of unity and Bo's run for a place in the party's innermost circle of power.

The warning came on 3 March from a senior central leader who told Bo and other assembled officials in Chongqing to be careful while attending the parliament session in Beijing.

"The climate in Chongqing is very different from the climate in Beijing," said the official, who several sources have told Reuters was He Guoqiang, the party's top man for keeping discipline and fighting corruption. "So I hope that everyone will take care against the cold and stay warm, and be careful to stay healthy."

Beijing's political winds indeed turned brutally against Bo. His removal as party chief of Chongqing was announced last week, stoking uncertainty about how China will manage a tricky handover later this year to a new generation of leaders at the 18th Communist party congress.

"... The tale involves allegations of corruption and abuse of power by Bo's family, bugging of senior leaders, and growing distrust..."

A reconstruction of the events leading to Wang's flight and Bo's downfall offers an insight on how China is run that reaches far beyond their political base in Chongqing, a smoggy city-province of 30 million people on the Yangtze river.

Wang's flight to the US consulate in nearby Chengdu was not the "isolated incident" Chinese officials first described. In interviews in Beijing and Chongqing, serving officials, retired cadres, Chinese journalists and other sources close to the government called it a climactic outburst of tensions that stretched back a year and involved the top reaches of China's leadership.

The tale involves allegations of corruption and abuse of power by Bo's family, bugging of senior leaders, and growing distrust between Bo and Wang.

Above all, Bo's rise and abrupt fall as a hero of leftist supporters exposed ideological rifts that threaten to tear at party unity if the leadership mishandles his departure.

"The loss of Bo Xilai means the whole balance of the 18th congress succession preparations has been disturbed," said Li Weidong, an editor and commentator in Beijing who has closely followed the unfolding scandal. "Finding the right equilibrium will be more difficult."

UK GUARDIAN / **LINK**

As global companies draw up contingency plans for a Greek exit from the euro, we examine the feasibility of Athens' departure – from new drachmas to illegality and €1 trillion costs.

It's a tradition of Greek theatre that the real action takes place off-stage. Much the same might be said of the euro drama.

A second bailout and last week's repayment of a €14.5bn (£12.1bn) bond has produced a dramatic lull in proceedings. Even the president of the European Central Bank said last week that the worst of the crisis is over. But does anyone actually believe there is not another Act to come?

Not if you look at what is going on behind the scenes. Whatever the politicians may pretend, governments, banks and companies continue to make contingency plans for a Greek exit from the euro. And, arguably, the terms of the latest bailout make one easier.

A quick recap of the state Greece is now in highlights the challenges ahead. Athens has got its debt down from €368bn – or a ruinous 163pc of GDP – by strong-arming the private holders of €206bn of bonds into accepting an effective 74pc loss on their loans, once lower coupons are taken into account.

That's been enough to trigger a second bail-out from the European Union and International Monetary Fund of €130bn – on top of the €110bn already advanced to Athens. But there the good news ends. The quid pro quo for all this dosh is the promise from Athens of unprecedented budget cuts. But, even after all the money and pain, by 2020 Greece's debt will still top 120pc of GDP, according to official estimates from the EU, IMF and European Central Bank troika.

That is, as Open Europe puts it, "more or less where Italy is today", which is "not exactly a hugely positive result after a decade of adjustment and hundreds of billions in taxpayer-backed bailouts".

Worse, the troika's estimates look horribly optimistic because, as the think tank points out, "the austerity targets are wholly unrealistic and kill off growth prospects".

Already into its fifth year of recession, more than half of Greece's under 25s are now out of work. Yet the government is promising to cut another 150,000 public sector jobs over the next three years. With protests on the streets and an election in April, who knows how much austerity is even deliverable.

The ink on the bailout terms is barely dry, but Germany's finance minister, Wolfgang Schaeuble, is already openly remarking that this is "perhaps not the last time that the German Bundestag will need to address the question of financial assistance for Greece".

Open Europe believes a third bailout or full-scale default is all but inevitable within "three years' time" – the price for Greece remaining in a currency it can neither print nor devalue.

"... Whatever the politicians may pretend, governments, banks and companies continue to make contingency plans for a Greek exit from the euro."

The euro, says US economic researchers Variant Perception, is like a "modern day gold standard, where the burden of adjustment falls on the weaker countries", forcing changes "in real prices and wages instead of exchange rates". Growth becomes "unlikely if not impossible within the euro straightjacket".

Hence the planning for an eventual Athens exit – not least by the Greeks. Some €16bn has been sent abroad since 2009, with Britain the favoured destination – as the mini-boom at the top of London's housing market might testify. Meanwhile, bank deposits in Greece have fallen by €70bn over the same period.

As the country's outgoing finance minister Evangelos Venizelos noted, while this is partly due to families or businesses raiding savings to cope with the crisis: "Many billions are kept in homes. They are, as we say, in mattresses or boxes."

UK DAILY TELEGRAPH / **LINK**

Italian Prime Minister

Mario Monti said on Saturday he was concerned about Spain's public finance situation and said contagion could easily return to the eurozone and affect Italy.

"It [Spain] certainly made decisive reform of the labour market but it did not pay the same attention to public finances," Mr Monti said at a conference in Cernobbbio, Italy.

"This is causing us a big concern because their yields are rising and it wouldn't take much to recreate the contagion that would also involve us," Mr Monti added.

Spain's long-term borrowing costs have crept back above 5pc, after falling as low as 4.815pc following the European Central Bank's second long-term refinancing operation (LTRO) in February, when European banks borrowed a total of €529.5bn at rates of just 1pc.

Spain also shocked markets last month when it said it had missed its 2011 budget deficit target of 4.4pc of GDP and a few days later set itself a softer goal of 5.3pc for 2012.

Olli Rehn, the EU's commissioner for economic and monetary affairs warned on Saturday that Spain must maintain fiscal discipline and stick to its target of cutting the deficit to 3pc of GDP by next year in order to retain market confidence.

Earlier this week, Citigroup's chief economist, Willem Buiter told Bloomberg that Spain was at "a greater risk than ever before" of a debt restructuring.

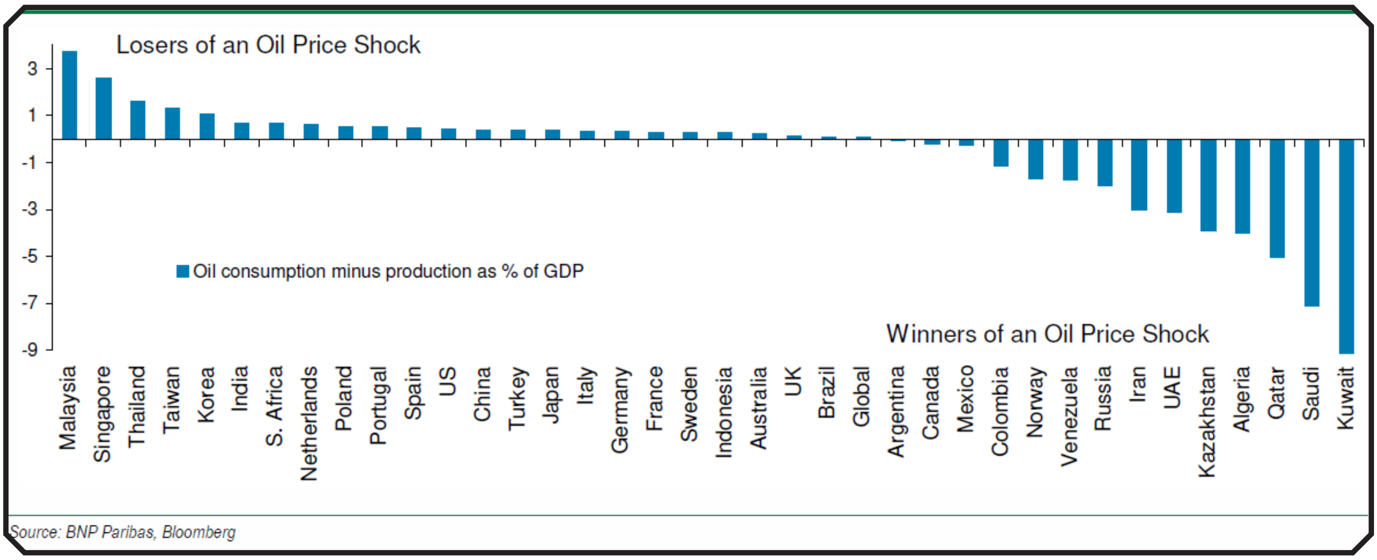
Italy, which has a €1.9 trillion (£1.6 trillion) bond market, the third-largest in the world, has also seen its borrowing costs rise in recent weeks. Yields on 10-year government bonds closed at 5.021pc on Friday, although this is far from the 7pc highs of November.

Speaking on Saturday, Mr Monti said that Italy's recession would be deeper without the reforms its government is implementing.

"I cannot promise growth in 2012, but less recession," Mr Monti said. "Italy is not in a brilliant situation and the emergency stage cannot be solved in a year."

UK DAILY TELEGRAPH / **LINK**

A look at the winners and losers of an oil price shock demonstrates just how dependant Asia is on affordable crude...



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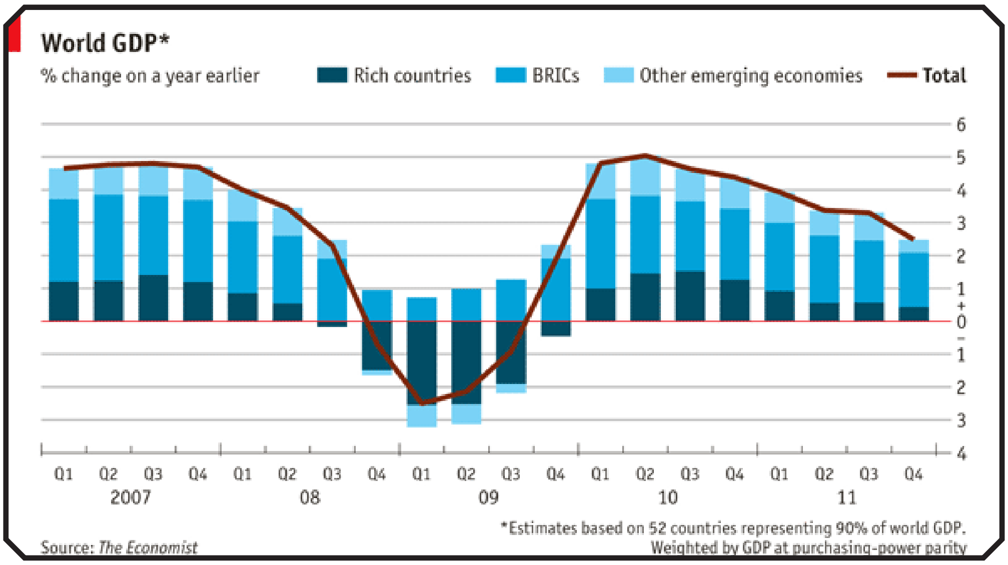
SOURCE: BNP/BLOOMBERG/ZEROHEDGE

The world's economic growth continued to slow in the final quarter of 2011, according to The Economist's measure of global GDP, based on 52 countries. Year-on-year growth fell by just under one percentage point to 2.5%. Developed countries' average growth slumped to less than half a percent despite a small uptick in the third quarter. The BRIC economies saw declining growth for a seventh successive quarter. In Europe heavy austerity measures have stifled growth; the economies of the Netherlands, Greece and Italy all contracted in the fourth quarter. Oil prices, which recently rose over $128 per barrel, are placing new pressure on the global economy. The news is not all bad, however; America's job market has started to pick up speed again. The latest quarterly results show the biggest increase



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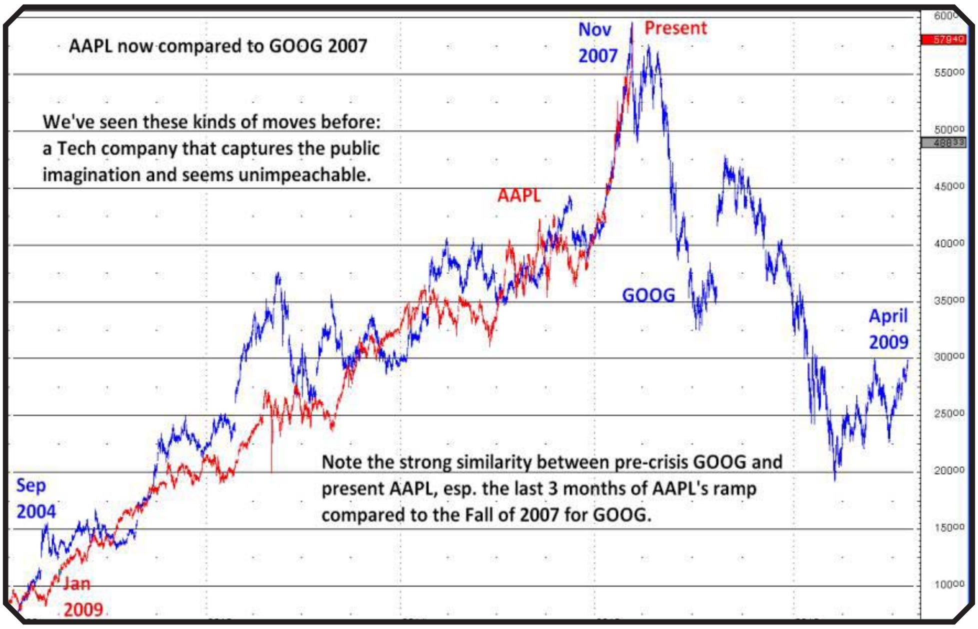
SOURCE: THE ECONOMIST



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SOURCE: SILVERSAXENA

Apple today vs.

Google yesterday makes for an interesting comparison...

SOURCE: SHARELYNX

The gold oscillator

is indicating that the latest move up by gold is a breakout.

There is good probability that gold has finished it's decline & the next wave should be up & taking out the recent highs at 1780.

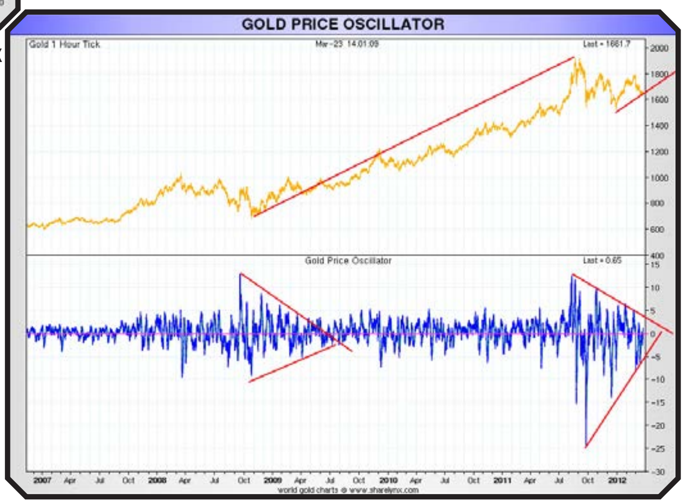
On a larger scale the impending move up - if it is strong enough ie. takes out 1800 & then 1900 - will then trigger a massive rise out of the triangle shown in the chart below.

This is indicative of a major rise coming in gold - something strong enough to take us up to the mid $2000's.

The first rise up off the bottom was from 1520 to 1790 - a rise of 270 or 17.7%

We are now down at the retest level and should move up from here so a 270 rise up from 1640 will take us up to 1910.

NICK LAIRD / LINK

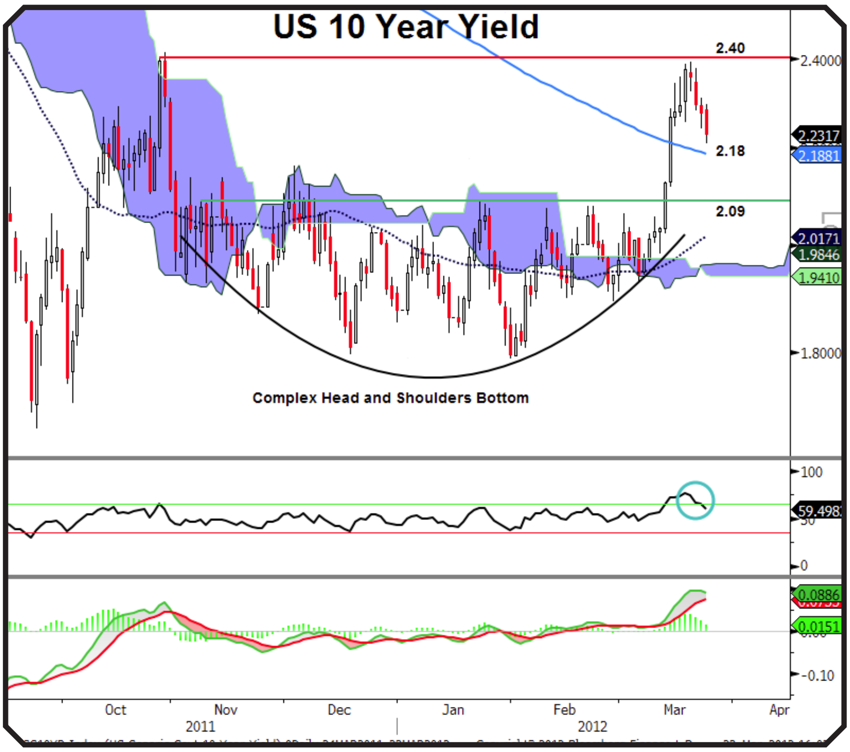


SOURCE: SHARELYNX

Richard Ross is back again and in fine form this week. Email him at rross@agco.com but in the meantime, enjoy his own particular brand of wisdom...

While Russia displays poor relative strength vs. the ACWI and EM Indices; the MICEX is off 6% in just the last five sessions, RSI remains supportive of a Bull trend, Brent acts exceedingly well, the Ruble is the best performing EM/Commodity Currency on a year to date basis, and the Index is sitting right on a delta of key support; all of which offers a compelling buying opportunity with a very well defined protective stop on a close below 1,518. We've moved to DEFCON 2 and the launch codes out, but this isn't 1962 and we're still hopeful a diplomatic solution can be reached. If you sell Russia here, you are selling the bottom tick of the move. I'm prepared to wait for my answer.

RICHARD ROSS

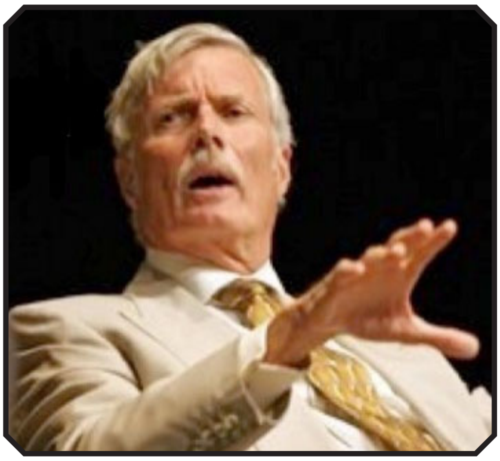


RSI has generated a confirmed sell signal for Bond prices, and we fully expect yields to hold the 200 day around 2.1881 on the pullback. While rates could see downside to 2.09, the recent spike is just the first shot across the bow. You have been warned. Sell bonds, buy stocks. Not necessarily in that order.

RICHARD ROSS

For anyone following silver over the past several years, the name 'Ted Butler' is one with which you will no doubt be familiar. In this interview with Jim Puplava, Ted explains how he believes the manipulation of silver futures is carried out and calls again for the CFTC to finish their 2-year investigation into what he explains looks like a very simple, open-and-shut case.

CLICK TO LISTEN



CLICK TO LISTEN

I was fortunate enough to spend some time chatting to John Embry in February and what an absolutely charming man he is. Not only that, but he is just about as smart as they come when the subject turns to precious metals and ten minutes listening to him is ten minutes well-spent. Always...

Perhaps a less judicious use of ten minutes of your time is to listen to me talking about bonds, but Al Korelin was kind enough to do just that this past week and so for anyone out there with ten minutes to spare you can find our chat here...

CLICK TO LISTEN

We haven't seen 'The Bears' for a while but they're back this week and discussing the high price of gasoline in the US.

Perhaps unsurprisingly, they link the rising price to forces other than 'evil speculators'... I'm sure you can probably guess who and what those forces are.

Watch out for the smoking gun chart at 4:08...

CLICK TO WATCH

Hmmm...

SUBSCRIBE UNSUBSCRIBE COMMENTS

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 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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